SIAL Canada
L'INSPIRATION ALIMENTAIRE

SIAL Foodhub SIAL

WHITE PAPER

DYNAMICS OF FOODSERVICE COSTS AND SALES PRICES

« THE MONTREAL PRINCIPLES » OR « THE COST-PROPORTIONATE METHOD »

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TABLES OF CONTENTS

1. LIST OF SIAL FOOD HUB 2016 PARTICIPANTS

List of SIAL Food Hub 2016 participants, during the "A Fresh Take on Foodservice Costing and Maximising Profit" summit organised as part of SIAL Canada on April 13th, 2016 in Montreal.

Moderator/Host: Robert Dion – Editor of *HRI* magazine

PANELISTS

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2. INTRODUCTION

Cost behaviour analysis in foodservice represents a major issue for all restaurateurs looking to optimise their establishment's profitability. This white paper aims to take a simple, accessible approach to sales-price setting, by taking into consideration operating costs as a whole. This approach is based on an array of management practices that stimulate the profitability of all restaurants, whether franchised or independent.

Experts from Quebec, Ontario, France, and Switzerland; franchised and unfranchised private companies; professional associations; training institutions; and consulting firms offered up a synthesized model that could sustain a reinvented approach to management in Quebec restaurants.

This document presents a short description of the current context in the Canadian foodservice industry, including specifics regarding Quebec, as well as a summary of discussions during the conference on the dynamics and the calculations of costs. In other terms, this is both an approach to foodservice sales-price setting as well as a set of recommendations on using the relevant management tools suggested herein.

The signatories of this white paper sincerely hope that the assessment and proposals set a precedent as well as take hold among both industry professionals and professional training schools, in order to help drive forward management in Canadian foodservice establishments and improve those businesses' profitability and chances of survival.

We would like to thank SIAL Canada for its guidance and for organising this conference, Robert Dion for his work coordinating and producing this white paper, as well as the experts who generously agreed to contribute to it.

PANELISTS QUOTATIONS

Global foodservice is currently undergoing profound changes, both in terms of both supply and demand, which forces establishments to adapt, particularly in regards to cost management."

"Customers know that, in a restaurant, in order to provide a low price, the owner will have to lower quality, and even engage in a certain amount of economic trickery."

- Bernard Boutboul

"By definition, foodservice companies' total production costs include the costs of 10 categories of key resources which are used to conduct business in foodservice. Very often, inefficiency costs can mount in each of these 10 categories. Inefficiency costs are supplementary costs that result from the use of unnecessary or unproductive resources being used to handle what's needs doing."

"Technology is crucial to development, and very useful in setting up a simple trend chart."

"If you don't know your customers very well, you have a problem. You always have to know how to adapt to their wants, needs and expectations. To get there, you need an information system. Costing helps you with your customers and with your revenue."

- Christian Latour

"As a manager, you have to be able to call yourself into question, and have a look at your own abilities when it comes to dealing with change."

"Technology is crucial to development, and very useful in setting up a simple trend chart."

"Mutualisation, or in other words, grouping together and collaborating, can be useful in obtaining resources and skills at a reduced cost."

- Christine Demen Meier

"Technology is a key tool in reducing the amount of time management spends in the office, time which would be better spent managing employees and customer service."

- Nathalie Lehoux

PANELISTS QUOTATIONS

"People are going to go wherever they find it pleasant. Decor needs to be regularly updated to ensure the right ambiance."

"It's easy to raise prices, since added sales will hide mistakes in terms of costing."

- Doug Fisher

"Before all else, maximise sales and ensure your customers receives excellent service."

"The choice as to whether to produce something in house is, above all else, a question of restaurant style."

-Pierre Moreau

"Average profits among Canadian restaurants reached 4.3% of pre-tax sales. The margins are extremely thin: On average, costs of goods were 34%, labour costs were 31.5% and rent was 8.2%. So, we're talking about decimals and cents in this industry."

- Shanna Munro

"Cost management shouldn't let you reduce costs at the expense of everything else, but instead allow you to understand costs. You have to know what the return is on each dollar spent."

- **Richard Scofield**

"Always be open to what's happening outside your restaurant, be ever ready to call yourself into question, and find ways to reinvent yourself to better satisfy your customers and better meet their needs."

- Stéphane Beauchemin

"The scale of the tourism industry, including foodservice, justifies increasingly developed research groups, as compared to other similarly sized industries which are better supported and served in terms of research studies."

- Bernard Aurouze

3. BACKGROUND ON FOODSERVICE

On April 13th, 2016, the experts at SIAL Food Hub 2016 in Montreal, Quebec unanimously asserted that the foodservice industry is undergoing profound changes and that it is faced with major challenges, notably in terms of profitability. This situation is particularly challenging for independent (unfranchised) restaurants and their "business model" needs to be re-examined.

According to Restaurants Canada, with more than $75 billion in annual sales, the foodservice industry directly employs more than 1.2 million people, a number which constitutes 6.9% of the active Canadian population, making it Canada's fourth-biggest employer.

With more than 91,300 establishments, the foodservice industry contributes to the economies of every one of Canada's rural and urban communities, and generates more than 4% of the Gross National Product (GNP).

With its ties to tourism, this industry is truly crucial to the Canadian economy, given the millions of jobs and numerous sub-sectors it needs to keep it running. Nonetheless, the profit margin is slim; bankruptcies are numerous, particularly in Quebec; and closures are frequent.

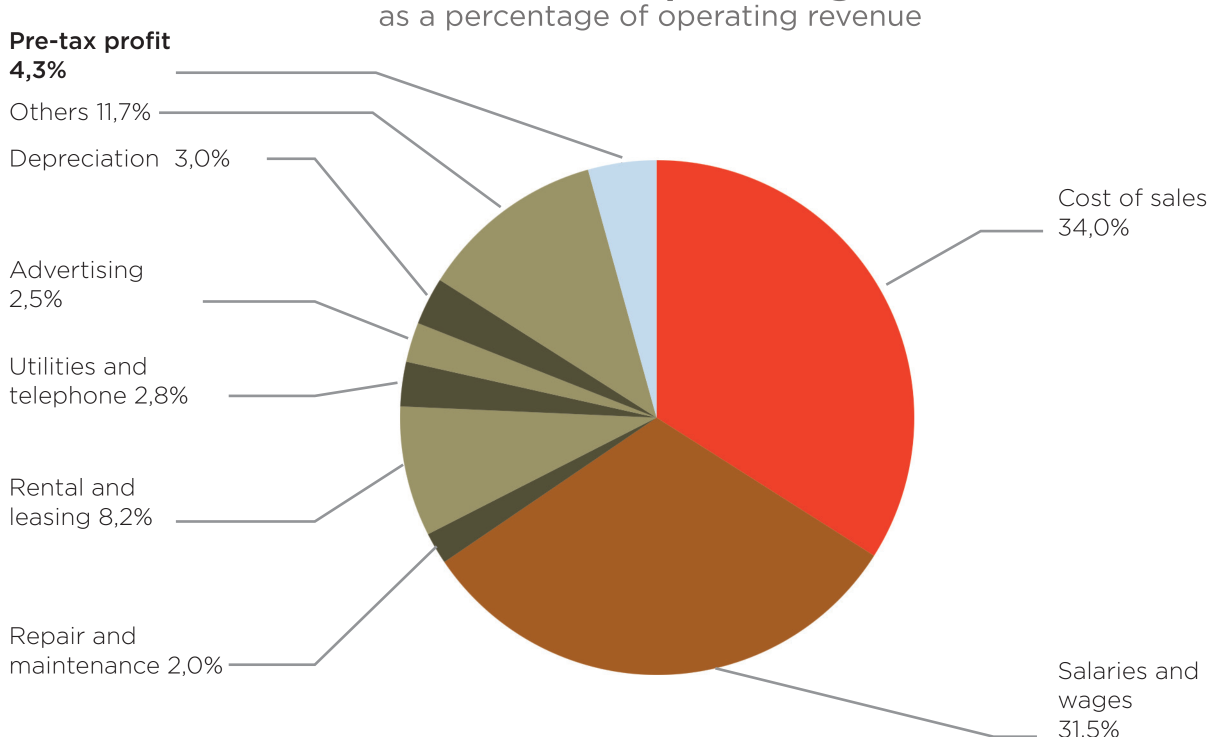
In Canada, the commercial sector experienced a 4.2% increase in sales in 2015 (as compared to 2014), which reached $60 billion. If one includes the non-business sector, total sales increased by 4.1% and nearly reached $75 billion.

Pre-tax profit for the average commercial restaurant in Canada was 4.3% of total revenue, in 2013. With an average unit volume of $631,000, the average operator earned an annual pre-tax profit of $27,100.

Cost of sales remains the largest expense for Canadian restaurant operators, representing 34.0% of operating revenue. Meanwhile, labour costs account for 31.5% of operating revenue. Labour costs have steadily increased in recent years due to rising minimum wages.

Rental and leasing costs are the third-largest expense for foodservice operators and stood at 8.2% of operating revenue in 2013.

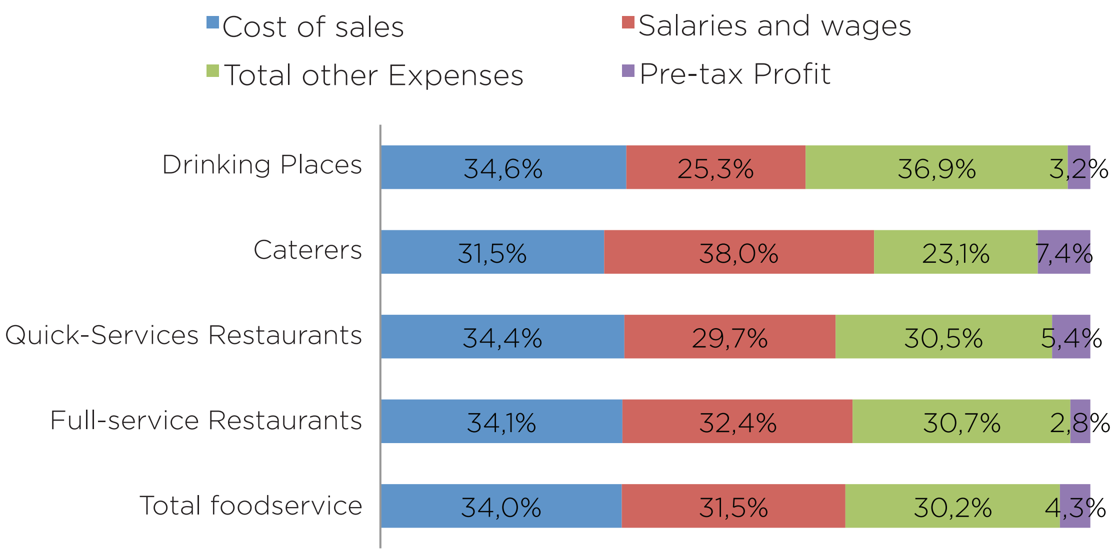
2013 Financial Operating Ratios
as a percentage of operating revenue



source : 2015 Operations report Restaurants Canada

Total sales within both sectors, commercial and institutional, should increase by 3.5%, to reach $77.5 billion in 2016. In general, in 2016, low prices for goods and services will continue to slow down economic activity in Alberta, Saskatchewan, and Newfoundland and Labrador. This had the effect of limiting growth in Canada in terms of total sales. By contrast, Ontario and British Columbia recorded solid increases due to their strong economic growth. The weakness of the Canadian dollar has encouraged international tourists to visit Canada, and also discouraged Canadians from visiting other countries. That combination should help strengthen the sales of restaurants located near the border or in tourist destinations.

Operating Ratios, 2013 Canada



Source: 2015 Restaurants Canada Operations Report

In Quebec, the number of commercial foodservice establishments rose to 22,599 units in 2015, as a result of the lowering of the number of full-service restaurants and drinking establishments, as well as an increase in the number of caterers.

Despite economic growth in 2015 (the fourth highest in Canada), the Quebec foodservice industry continues to suffer from a decrease in the number of establishments that are either full-service restaurants or drinking establishments. The decrease in the number of independent operators is made up for by the strong growth of franchise restaurants.

By contrast, and in keeping with 2014, sales at full-service restaurants only increased by 0.1% in 2015, reaching $5.3 billion. Sales in this sector stumbled over the last few years due to a decrease in the number of establishments and lowered consumer spending on lunch and dinner. Since we have seen increased consumer spending on breakfast and brunch, we can conclude that customers are looking for practical options. Overall across the country, breakfast and brunch represents 17% of total spending at full-service restaurants.

Still in Quebec, sales within the catering sector increased by 4% in 2015, reaching $821 million, after nearly failing to register growth in 2014.

For the third year in a row, sales at bars, pubs, taverns and nightclubs fell by more than 8%. Since 2010, sales at drinking establishments decreased by 26% due to a decrease in the number of such establishments and due to an aging population.

Better economic growth in Quebec, as well as increased job creation and tourism will stimulate sales at commercial restaurants by roughly 2.3% in 2016, after average growth of 1.4% over the last three years. The increase in the number of establishments and of customers looking for a specific service should support growth within the quick-service sector. Previously suppressed demand should boost sales at full-service restaurants, following relatively stable sales in 2014 and 2015. Another decrease in the number of units would lower customer spending at drinking establishments.

Changes within the foodservice industry echo those regarding customer behaviours around food. Perception of the quality of the food and service is very often linked to the price requested. Very high prices create expectations that are just as high, and too low of a price can make customers flee.

In the context of intense competition, as is the case in foodservice (22.600 restaurants in Quebec and 91,300 in Canada), pressure to lower sales prices is very high, since there are so many restaurants. Customers, therefore, have a plethora of options and will frequent foodservice establishments that best meet their needs at the right price. Restaurant operators that do not have sufficient tools or information are hesitant to increase their prices out of fear of seeing their customer base shrink and thereby losing their sales to their competitors.

> Outside the home, customers are looking for "enjoyment", particularly when going to a restaurant. The expected advantage depends on the choices available, the time of day, and the context (travel, work, meeting, leisure, etc.) Some restaurants place emphasis on the quality of the plate, others on the experience and the decor, but everyone understands that the combination of elements will be sought after and found by the customer is key. It can therefore be dangerous to lower quality by reducing costs, since this can have a negative impact on customer satisfaction.

Furthermore, product and service quality is directly linked to the costs involved in preparing and delivering service, and if the restaurant operator pays as little as possible for their ingredients and staff, they commensurately put at risk and could decrease the enjoyment that customers experience. Nonetheless, excessive quality and inefficiency bring about supplementary costs that don't contribute to the quality perceived by the customer and, as much as is possible, these needless costs should be eliminated.

Examples of "excessive quality":

- overly large portions
- excessive service staff
- over-priced ingredients
- embellishments that are needless or are imperceptible by the customer

Examples of "inefficiencies":

- mistakes during processing of raw ingredients
- wastage
- waste (over-production)
- production errors
- delivery errors
- wait times
- absence of inaccuracy in forecasts

- The difficulties encountered within this industry demonstrate that the traditional managerial approach, based on intuitive and approximate financial tools, is no longer relevant and does not allow for a restaurant's survival. In fact, frequent increases in all of the variable costs (food and labour) as well as the fixed costs (rent, property taxes, permits, energy, advertising, insurance, etc.) should logically result in increased sales prices. Furthermore, since competition is fierce and the purchasing power of Canadians, and more notably Quebeckers, is limited, this causes restaurant operators to be cautious.

Instead, they turn towards cutting costs, without calculating them proprely. Potential lightening of the cost structure, even if unmeasured, gives the impression that profitability will be increased. All the members of the panel denounced this approach and labelled it as dangerous. In response to this "cost controlling" approach, experts first set up warnings and then suggest implementing permanent tools to ascertain one restaurateur's own numbers.

4. COST BEHAVIOUR ANALYSIS

Restaurant operators incur different types of expenses while producing and serving the food and brevages offered at their establishments. There is truly a wide variety of inputs, including material resources (ingredients), equipment, financial resources, information resources, and labour, supported by technical know-how and powerful management tools. By combining these resources, the foodservice operator creates a value-added product/service that aims to maximise customer and employee satisfaction, as well as profits.

The costs of various resources interact with one another. Restaurateurs need to make choices, and learn, invest more in one or the other. For example, buying pre-made products, investing in the decor, buying rare or fresh ingredients, investing in a POS system, making use of technologies like “sous vide”, investing in marketing, training one’s staff, etc.

Decisions taken on different types of costs will create mutual consequences among them. We acknowledge that the choices made on the kind of ingredients bought in a raw state range 1, or ranges 2, 3, 4 and 5 are put to use, and the choices made on labour competencies will influence globally the cost of sales involved in producing a plate (food resources. The “ranges of products” refer to a system of classifying raw materials used in “assembly cooking”. For more on this topic, see Jean-François Poulin’s “Cuisine d’assemblage” (assembly cooking).

While these certainly represent important issues in terms of ensuring a restaurant’s profitability, costs should also be a reflection of the quality needed to satisfy one’s customers. Once they’re set, costs therefore basically represent a source of information about the expected operation and performance of the restaurant, which allows for verification of whether quality is delivered and maintained.

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For a restaurant, the most substantial costs are:

- cost of sales or ingredients (variable)
- labour costs (variable and fixed)
- occupancy costs (fixed and partially variable)
- other operating costs (fixed and partially variable)

Fixed costs are critical because they have a direct influence on a restaurant's ability to attain minimum profitability, whether that be with great ease or difficulty. It is therefore, above all, essential to minimize these costs, in order to make it easier to reach profitability. The panelists mention frequent cases of restaurants whose break-even point is unattainable, making it so that these establishments are condemned to close their doors before long.

Variable costs are important because they generally relate to perishable goods that require processing which involves higher-level worker skills. In foodservice, the ways of falling into losses, waste, theft, over-purchasing and shortages are many. In addition, they also correlate with labour, whose productivity can vary tremendously. Labour costs related to culinary production, to service, to managing the establishment, and to maintenance, partially varies based on volume. In reality, these costs are semi-fixed and represent an important part of total costs.

Anticipated profits are normally proportional to the investment made. Major investments imply high expected profits, and vice versa. In the end, the restaurant, as an economic unit, must cover variable fees and fixed fees, in addition to generating a minimum amount of profit in order to justify its own existence, through sales, number of customers, items ordered and each of the prices displayed on its menu.

In order to increase their knowledge, we recommend that restaurant operators consult CANADIAN RESTAURANT ACCOUNTING STANDARDS, by Douglas P. Fisher, BAS, MSC, FCMC, FCSI and published by Restaurants Canada.

The recent increases to the minimum wage in Quebec have created a number of challenges for the many restaurant operators who were not prepared for these sudden hikes in labour costs. This phenomenon will continue in the future. Recently, the news has carried stories about the numerous protests being held in several cities across North America to demand an increase of the minimum wage to $15. Several US states are currently preparing referenda on the matter.

Issues related to managing labour are critical and numerous because they represent what the panelists consider an establishment's most precious asset. Foodservice operators are invited to learn more about the specific concepts in human resource management, employee evaluation and productivity measurement. Management consulting firms can normally serve as invaluable allies.

Finally, the panelists insist upon the undeniable usefulness of mutualisation, which allows for the sharing of resources or the securing of optimal prices from suppliers. To this end, Restaurants Canada has devoted considerable effort to obtaining significant financial advantages for its members.

Here we will introduce the basic economic concepts that will lead us to specific applications within the foodservice industry. While the customer base in an important factor, we will not touch on it in this study since it is more so about sales prices. Foodservice operators are welcome to learn more about marketing through additional studies.

Restaurant sales are a result of the customer base, in other words, the number of units sold to all customers and the price of the items sold. The panelists were unanimous that the priority should be to maintain and grow customer base and therefore sales, without which profitability is unattainable.

Sales = items sold* X *sales price

To generate sales prices, the economic approach suggests considering both costs and the customer's ability to pay, added to these costs a variable profit margin that ensures the business's continued operation and a reasonable return on investment.

Menu item prices are the result of all costs, balanced one against each other, marked up for anticipated profit, in order to ensure the establishment's profitability.

Sales = materials costs
+ labour costs
+ general fees
+ anticipated profits

When looking at a specific item, divide by the total number of items to obtain the per-unit cost. This sequence will become our theoretical base.

$$\textit{Item Sales price} = \left(\begin{array}{l} \textit{Item material costs} + \\ \textit{Labour costs} \\ + \textit{General expenses} \\ + \textit{Item Anticipated profits} \end{array} \right) / \textit{Items sold}$$

It is worth noting that over time, ingredient and labour costs constantly and inexorably increase. These costs will continue to grow and this trend will remain in effect well into the future. A number of approaches are recommended in order to mitigate these increases. In the end, rising ingredient and labour costs will be reflected in items' sales prices.

A sales-price calculation system is therefore needed in order to take into consideration these inevitable increases and avoid delays regarding reactions that might prove damaging to a business.

These two types of costs are variable, or semi-variable in the case of labour costs, depending on the volume of customers served and of revenue. Therefore, we'll use a shared base of 100% when discussing percentages.

Since they are relatively more less variable, it's important that leasing, general expenses and operating costs, which are largely considered fixed costs, be properly negotiated over at the time of signing or making a purchase. It is usually necessary to produce realistic sales estimates in order to see whether these fixed costs are potentially reasonable.

In Canada, leasing costs, including rent, reached more that 8% of sales and 7.4% of sales in Quebec. Recent spikes in real estate and in real estate tax accounts have caused rent increases, which continue to increase. We are occasionally seeing downward adjustments to certain rents, notably among chain or independent restaurants which manage to negotiate lowered rents with the owners of their buildings. Fixed costs are therefore not related to operations, but are instead more a product of fruitful negotiations with suppliers.

Fixed fees are directly related to the break-even point, and thus are critical to a restaurants survival. It is therefore in the best interests of foodservice operators to periodically measure the break-even point in order to be aware of their business's ability to generate profits.

5. BEST PRACTICES IN COSTING

Nonetheless, it seems that cost behaviour analysis is complex and directly linked to a business's values and methods. The SIAL Food Hub experts' general recommendations regarding best practices are as follows:

- determine the product/service based on target customer needs
- select a niche (product, quality, price)
- be aware of your costs
- understand your costs
- set up goals and create indicators
- measure those indicators
- analyse the results based on the goals

All this involves mastery of a broad range of skills including: culinary production, customer service, marketing, human resource management, inventory management, and business analysis, etc. So, while clearly and effectively setting one's sales price is essential, it isn't enough to ensure profitability.

Today's restaurateur must have skills in a variety of domains (marketing, human resource management, cuisine, service, hygiene and cleanliness, communications, nutrition, accounting, finance, foreign languages, law, IT, etc.) In general, we have noted the lack of preparation on behalf of foodservice entrepreneurs, as well as their lack of management skills. Many even neglect to put together a business plan before opening their establishment.

Among the tools proposed for use in calculating foodservice costs, SIAL Food Hub experts mentioned the following:

- monthly, and even weekly, inventory (bar inventory should be daily)
- studies of productivity of processed products (coefficient)
- standardised recipes
- standard costs
- calculation of actual and theoretical costs
- employee productivity (revenue per working hour)
- worker training plan (because mistakes can prove costly)
- sales analysis

For certain foodservice businesses, management work mainly involves measuring and monitoring costs and performance indicators in order to be able to react quickly and take the necessary decisions to maximise profitability.

The end goal of this meticulous calculation of costs is to closely monitor performance indicators. Performance indicators are established based on the company's goals. While they are paramount in order to make consistent decisions, by their nature, they require forethought about the company's desired positioning. However, comparisons with industry averages can be misleading, and often even dangerous. It is therefore recommended to instead compare with your own performance history and goals.

Among the panel's recommendations, we have chosen to highlight the following practices, which can be effectively paired with performance indicators:

A. LEVEL OF CUSTOMER SATISFACTION

Absolutely paramount in foodservice, customer satisfaction deserves constant attention and major investment, failing which, sales risk suffering. Given that the criteria and balance will vary from one restaurant to another, it's essential to put together the right tools and evaluation scale.

B. LEVEL OF EMPLOYEE SATISFACTION

A valuable indicator of the working atmosphere, employee satisfaction is directly linked to the quality of the work, the skill of the employees and their intention to remain a part of the company. This indicator also allows you to detect potential sources of dissatisfaction and to react to them accordingly. In-house tools are also necessary given the specificities of each establishment.

C. PERIODIC THEORETICAL COST OF SALES (MONTHLY OR WEEKLY)

Theoretical costs allow for the estimation of the cost of the ingredients that would have been theoretically needed to produce the food that would have been sold during a given period. It is calculated by getting the sum of the products (standard costs x number of items sold) during a given period. It is then compared with the actual cost of sales in order to calculate the establishment's performance as regards to ingredient use.

Theoretical cost **=** ***Sum of (number of items sold during a given period*** **X** ***Unit standard cost)***

D. ACTUAL MATERIALS COSTS

The actual materials costs are an exact calculation of the ingredients that were actually used during a given period to produce the food for that period. Ideally, the actual materials costs should be calculated on a weekly basis, since a monthly calculation is too vague, given that it's based on a period of time that's too long to allow for an effective reaction. The actual cost of the materials used is calculated by adding the inventory at the beginning of the period to the purchases during that same period, and then subtracting the inventory at the end of the period. It is then compared with the theoretical cost; the lower the disparity between them, the better the performance during that period. The actual materials costs also allow for the detection of employee theft, oversized portions, losses due to accidents, and other inefficiencies that have a negative impact on profitability.

Actual cost of sales $ = Beginning Inventory $
+ Purchases $
– Ending Inventory $

E. ASSUMED WEEKLY SALARY COSTS

Based on sales projections, it is preferable to check if work schedules will involve reasonable labour costs relative to these projections. If the salary costs seem too high, there is still time before posting to correct the work schedules and reduce likely labour costs. We also suggest measuring the "revenue per working hour" (RWH) and to compare it to its previous performance. Revenue is divided by the number of hours worked during a given period.

F. OTHER FIXED EXPENSES

While, by their nature, fixed fees are relatively easy to project, we suggest measuring their weight relative to accumulated sales so far. As it happens, at year's end, leasing costs should make up less than 8% of sales, marketing should be a minimum of 2 to 4% of sales, and royalties are normally proportional and occur based on the restaurant operator's franchise status.

Overall, calculating costs, ratios and statistics is essential to monitoring and understanding costs. These indicators allow for the detection of increases/decreases in sales and costs, as well as providing information needed in informed decision-making.

Writings regarding “foodservice operational monitoring” also suggest other performance indicators, such as “average check”, “seat turnover rate”, “service time”, “REVPASH” (REVenue per Available Seat per Hour), “PROPASH” (PROfits Per Available Seat per Hour), “hourly sales”, “profit margin per item sold” and “Staff productivity rate”. Normally, POS (Points Of Sales) systems make it easier to calculate these performance indicators.

In conclusion, efforts devoted to collecting, measuring and analysing data represent an important strategic factor for restaurants looking to survive and grow. In particular, calculating and monitoring the various costs allows you to receive feedback on customer satisfaction, on employees, and enables close monitoring of the dollars spent on food, labour and other fixed and variable fees. In this way, the restaurant operator will have the relevant information at hand to call things into question or, for example, to put in place a performance-based bonus system.

6. PRICE SETTING

The "Food cost x 3" price-setting method is no longer relevant, and any restaurant operators still using this method are fated to eventually closing down their business. This method doesn't allow the manager that uses it to understand the dynamics or the cost structure related to sales prices. By simply multiplying estimated food costs by an arbitrary coefficient, the restaurant operator loses sight of the part taken up by the other charges. Decisions related to employees and rent are taken without being considered within sales prices, making the whole exercise random and harmful. Despite its simplicity, the "Food cost x 3" approach should be allowed to disappear and be replaced by an approach that is more inclusive of the totality of the costs involved in producing and serving food and in generating a reasonable profit.

Based on the remarks by the panelists who were part of SIAL Food Hub 2016, which took place at SIAL Canada in Montreal, we have synthesised a logical, comprehensive and effective approach to foodservice sales-price setting, the "Cost-Proportionale Method".

OPTIMAL PRICE SETTING IN FOODSERVICE "Montreal's Principles"

Optimal price setting relies on a variety of tools and methods that are interconnected. These tools and methods also have indirect uses for managing food production, task management, deriving productivity measurements, and managing cashflow, just to name a few benefits. It is worth noting that other accounting and financial tools could also contribute to better sales-price setting. We will present the tools and methods mentioned during SIAL Food Hub.

A. STANDARDISED RECIPES (PRECISE STANDARD COST INCLUDING SALT AND PEPPER)

Each recipe is standardised and abided by in the kitchen. Per-portion costs are therefore equal to the sum of the costs of each ingredient, keeping in mind processing losses and per-unit purchasing cost (kilograms or litres). Bearing in mind that actual processing-related losses can vary based on employees' skill levels. Establishing standardised recipes is an important task for a business. Employees must be made to follow recipes rigorously in order to ensure a constant cost level, but also to ensure consistent quality and preparation times. Standardisation is a key factor in foodservice success.

B. COMPARE AGAINST COMPETITORS (COMPETITORS' SALES PRICES ARE DIVIDED INTO THREE GROUPS: HIGH, MEDIUM AND LOW, IN ORDER TO ALLOW YOU TO SET THE HIGHEST PRICES POSSIBLE FOR THE TARGET MARKET, RELATIVE TO THE COMPETITION)

Every establishment operates within a market made up of competitors offering essentially the same product/service or who satisfy the same customer needs. As much as is possible, you should compare competitors' prices to your own to establish a sensible positioning in terms of quality and price. It is on this basis that the customer will make their decision between establishments serving the same market (CompSet or Competitive Set). If possible, we set prices according to competition by playing on costs.

C. SET A PRICE WITH A POSITIVE MARGIN (ITEM PRICE – COST OF ITEM = UNIT MARGIN PER PLATE)

All prices appearing on the menu should be higher than the costs related to the item in question. Several calculation techniques are possible, but the "x3" technique should be avoided since it do not allow to understand all of the costs related to producing and serving a plate. Item prices should reflect all costs related to production, service, use of the premises, and other general fees necessary to the restaurant's operation. In foodservice, we can support one or two "loss leader" on the menu, to attract clients, within a coherent pricing strategy. In general, items appearing on the menu should all generate a positive margin.

The formula for setting sales prices, bearing in mind all costs per plate, is as follows:

Standard cost of the plate
+ Average labour cost (average)
+ General expenses (average)
+ Anticipated profit per plate
= Sales price

This method will be enough for restaurants with small menus, which include plates that are essentially the same. However, it will not work with categories like appetizers, desserts, drinks and sides.

The following sales-price-setting formula takes into account the different costs proportionate to revenue. Uncertain results are put on labour costs instead of food cost.

Sales price =

$$\frac{\textbf{\textit{Standard cost of the plate}}}{\textbf{\textit{(100\% - Labour in \% - Rent in \% - Other fixed fees in \% - desired profit on the plate in \%)}}}$$

Example: Sales prices of a “salmon tartar” plate

$$SP = \frac{5{,}00\$}{(100\% - 40\% - 8\% - 16\% - \mathbf{9\%})} = \frac{5{,}00\$}{27\%} = 18.52\ \$$$

- standard cost of sales for a plate = $5.00
- labour costs in % = 40%
- occupancy costs in % = 8%
- other variable and fixed costs in % = 16%
- desired profit on the plate* = 9%

*The percentage of the desired profit from a plate can vary from one plate to the other, depending on its popularity or on sales objectives.

This price of $18.52 will be adjusted based on competition and customers’ ability to pay and then rounded up, for example to $18.75.

D. STREAMLINING THE MENU (MENUS BENEFIT FROM BEING AS SHORT AS POSSIBLE; VERY OFTEN CERTAIN ITEMS DO NOT SELL AND INVOLVE COST OF SALES AND WASTED LABOUR)

Analysing sales will often reveal that certain items are popular or unpopular. A "menu engineering" approach, which calculates each item's contribution to sales and the profit margin, can allow you to make choices and eliminate less-profitable menu items. It often follows that restaurants will offer different menus at lunch and at night.

E. CREATING SHORT-TERM PROMOTIONS (OVER-LONG PRICE DROPS LOWER YOUR PERCEIVED VALUE AMONG CUSTOMERS)

The goal of promotions is to bring in new customers during periods that tend to be slower, by offering a higher-than-normal price-quality ratio. Beyond a certain period of time, for example a few weeks, the reduced price becomes normal to customers and the restaurant operator finds themselves locked in by their own promotion, without being able to even increase its customer base. Overall, too long of a price drop can prove harmful for all of the industry, which then has no choice but to adopt that discounted price in order to be able to preserve its market share.

F. COMPARING OFFERED PRICE TO REQUESTED PRICE (IN ORDER TO FIND OUT IF PRICES ARE OVERLY OR INSUFFICIENTLY HIGH, RELATIVE TO CUSTOMER DEMAND)

In order to determine if a price needs to be raised or lowered based on customer expectations, we recommend comparing the "average price offered" (average of the prices on the menu) for a category of plate with the "average price requested" (average price that items are sold at). If the "offered price" is higher than the "requested price", that means that the category of plate on the menu is not well balanced and should be lowered. Conversely, if the "offered price" is lower than the "requested price", it's possible to ask a higher price for this category.

7. FINANCIAL INFORMATION SOURCES

In order to ensure that all expenses (costs) are charged and considered, restaurant operators can benefit from information that has been compiled in their accounting system. It's in the restaurateur's advantage to set up their accounts and then to rigorously stick to the nature of the expenses when recording them.

Using accounting reports, restaurant operators can monitor changes in terms of revenue and expenses by making certain adjustments, such as amortisations and financial expenses (interest on capital) as well as other expenses which are not really related to taking out funds.

When it comes to accounting information, it would be advantageous to take other operational data into consideration, from the POS (Point of Sale) system or personal notes. This data can be tied to the customer base, the number of plates sold, the opening hours, the number of employees, the number of hours worked, the temperature outside, the time of day, to holidays, etc.

To sum up, it would be to restaurant operators' advantage to build a dashboard in order to monitor changes in sales, costs and performance ratios, as they relate to their objectives. This information will be invaluable for setting sales prices.

8 CONCLUSION

A number of panelists echoed the point that foodservice is, above all, a business, and that restaurant operators must calculate, know and understand their costs. The traditional intuitive and approximate approach on financial and quantitative issues is out of date and entrepreneurs that base themselves upon that business model will be faced with constant trouble. The "Food cost x 3" sales-pricing method is a relic of a bygone model. Today's restaurant operators will call upon methods that involve more thought and which take into account all of the resources that make up food production and service costs within their establishment.

This white paper suggests a comprehensive set of practices and tools, which were already generally known, but that prioritise knowing and understanding one's foodservice costs. These practices and tools fall under the responsibility of each manager and redefine their roles as planners, comptrollers, and decision-makers within the business.

Mastery of these practices involves skills from a variety of disciplines, which are not simply limited to inventory management or accounting entries. They also involve employee management and marketing efforts. This all implies a certain professionalism around being a restaurant operator, which doesn't just include years of experience in order to consolidate knowledge and skills, but also a basic training programme and ongoing training.

Professional associations, educational institutions, consulting firms, and government bodies concerned about changes in the Canadian foodservice industry have a stake in professional training for restaurant managers and their involvement in promoting management best practices would be invaluable to restaurant operators.

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