A Study Conducted for the Coca-Cola Retailing Research Council by The Hale Group, Ltd.

Understanding Supply-side Costs and Strategies for Supermarket Foodservice

BUILDING A MEAL SOLUTION DELIVERY SYSTEM

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The Coca-Cola Retailing Research Council (CCRRC) was created by The Coca-Cola Company to address issues of strategic importance to the U.S. supermarket industry. The CCRRC is responsible for identifying and framing the strategic issues to be addressed. The process allows:

- Retaining a consulting resource(s) to conduct the research and analysis associated with the identified issue
- Directing and guiding the conduct of the research and analysis
- Assuring the results are reported/presented to the supermarket industry in a way that is useful to and actionable by the industry

The CCRRC consists of 12 supermarket industry executives who carry out the responsibilities and tasks associated with the previously mentioned CCRRC mandate. They are:

Alan McClay, Comite International des Enterprises a Succursales (CIES)

Herb Young, formerly with Dominick's Finer Foods

Tim Hammonds, Food Marketing Institute (FMI)

Carole Bitter, Friedman's Supermarkets

Charles Genuardi, Genuardi Supermarkets, Inc.

Ned Dunn, formerly with Harris Teeter, Inc.

Fred Ball, Hen House Markets

Dan Kourkoumelis, Hughes Family Markets

Neil Golub, Price Chopper Supermarkets

Phil Francis, Shaw's Supermarkets, Inc.

James B. Meyer, Spartan Stores, Inc.

Terry Peets, formerly with The Vons Companies, Inc.

The Hale Group was chosen as the consulting resource to work with the Coca-Cola Retailing Research Council. The subject matter and its strategic importance to the supermarket foodservice industry and the quality and dedication of the Council members, their staffs, and other resources made this a milestone experience.

The Hale Group was able to successfully complete its task because of the two key constituencies, i.e., the Council and The Coca-Cola Company through its divisions, Coca-Cola USA and The Minute Maid Company, that provided constant support, guidance, and encouragement as the research and analysis were conducted. Others were also contributors; manufacturers, commissary operators, and wholesalers/distributors were all most generous and helpful. As a result of the sharing of information, the supermarket foodservice industry will be in a better position to be a preferred meal solution provider to the consumer.

The facilitator of the Council and The Hale Group's day-to-day client contact was Bill Bishop, founder and president of Willard Bishop Consulting, Ltd. Bill was a valuable guide and contributor to the assignment throughout the analytical process. The process was more fruitful and actionable because of his involvement.

This report would not have been possible if it were not for supermarket foodservice industry participants who openly shared their information and operations with The Hale Group staff. In particular, the Council members involved with this assignment provided valuable and fruitful direction for the study.

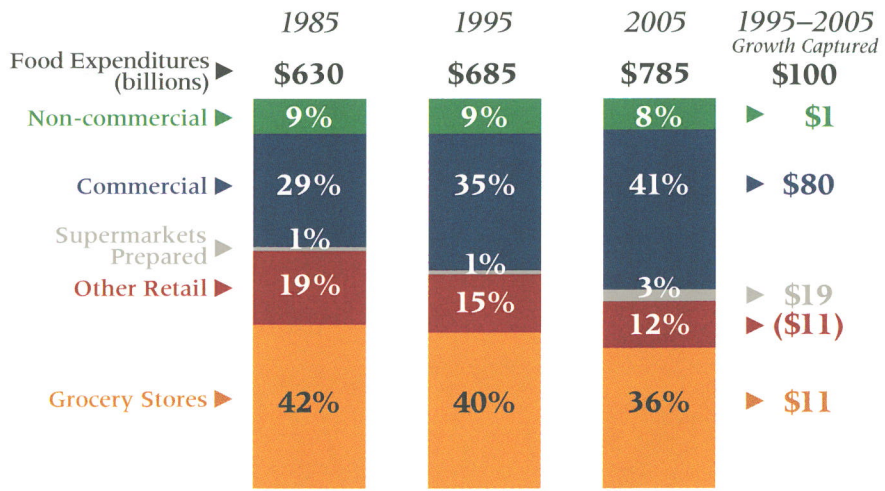
CONTENTS

THE COMPLETE REPORT

Building a Meal Solution Delivery System: Understanding Supply-side Costs and Strategies for Supermarket Foodservice was the topic selected by the CCRRC for this study. The background that led to this selection included the following.

- U.S. consumers are increasingly making the decision to purchase freshly prepared meals, rather than ingredients to prepare meals at home.
- The foodservice industry has benefited from this trend; restaurants have been the primary suppliers of prepared meals.
- The supermarket industry recognizes the potential opportunities in freshly prepared meals.
- To sustain continued investment in supermarket foodservice, freshly prepared meals must offer consumers an acceptable or superior value proposition and an attractive financial return for supermarkets.

Consumer Food and Beverage Expenditures, by Type of Retail Outlet



Source: **Foodservice 2005**, *International Foodservice Distributors Association*
Note: Non-commercial = Colleges, Schools, Healthcare, Business & Industry Feeding
Commercial = Restaurants, Hotels, Recreation
Other Retail = Clubs, C-stores, Specialty Retailers

STUDY OBJECTIVES

The primary objectives of the research effort were to:

1. develop an understanding of the costs associated with providing "restaurant-quality" prepared meals in a supermarket environment; and

2. identify ways to manage those cost elements to improve supermarket foodservice performance.

REPORT FORMAT

This report is presented in a slightly different format from previous CCRRC reports so it is easier to quickly access the information the reader wants and needs. This report is organized to:

- allow readers to read or use only that part of the report/analysis that is of greatest interest or relevance to them—each page attempts to stand alone;
- analyze each line item cost in the supermarket foodservice Profit and Loss Statement (P&L) and do so in one page, or at most two pages; and
- direct readers to other sources of relevant information when appropriate.

REPORT OUTLINE

This report is divided into four chapters.

Chapter 1: "Report Introduction." This chapter provides a background and framework for the research, analysis, and report.

Chapter 2: "Strategic Framework for Supermarket Foodservice." This chapter lays out the basis for formulating a framework within which each supermarket management team can determine strategic direction/positioning of the foodservice offering; the process for converting positioning into an operating foodservice concept; and the business process to manage the foodservice operation.

Chapter 3: "Understanding and Managing Supply-side Costs." This chapter details the basis for isolating and managing specific costs associated with supermarket foodservice operation, by P&L line item.

Each cost component is considered from the following vantage points:

1. Definition of Cost Component

2. Current Situation—What was the observed experience with this cost element

3. Opportunity for Improvement—How to better manage the cost components or achieve a better cost (and, thus, profit) performance

4. Tool Kit—The tools that can assist in managing each of the costs when appropriate

5. Next Steps—What readers can do to assess their positions vis à vis targeted costs

Chapter 4: "Next Steps." This chapter summarizes the process for improving the P&L of a foodservice operation and for developing a foodservice identity unique to the readers' organizations.

APPROACH

The study approach is shown in the exhibit below.

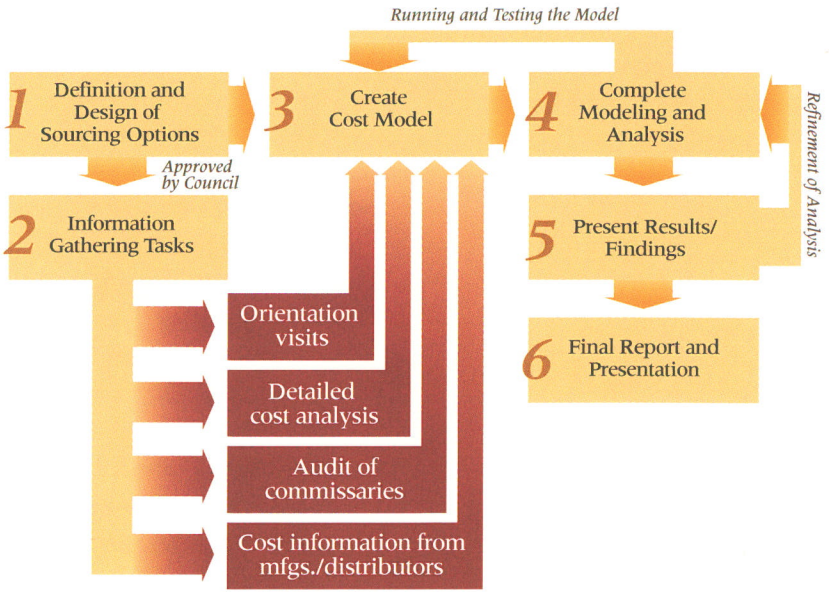
The first step was to develop the framework and scope of the research effort and to define:

- the meals/menu to be offered;
- the operating system used to create the meals/deliver the menu; and
- the level of cost detail needed.

The menu used in this cost analysis included:

- 14 unique items (defined in Appendix C); selection criteria designed to encompass classes of products based on preparation characteristics;
- 2 different product positionings—popular- and premium-priced to illustrate interaction of costs, pricing, and value creation; and
- selected sourcing scenarios (see section on Sourcing Options for definition and description of each variation).

A cost analysis was conducted on each of the scenarios to understand the costs, their interaction with other cost elements, and cost-drivers.



Study Approach and Work Flow

DATA SOURCES

Information for this study was collected from a number of sources. However, the key is that the cost information, financial model, and observations are based on the real operating experiences of a broad range of industry participants.

The cost information was openly shared with The Hale Group so the relationships between operating models and their impact on costs generated could be documented.

While the model input represents the actual results realized in the industry today, the output presented in this report does not reflect any one supermarket but depicts the general results of the industry or, in some instances, the cost expectation based on scenarios The Hale Group defined.

STUDY OUTPUT

This report represents The Hale Group's analysis to provide the reader with:

- an understanding of costs associated with operating a supermarket foodservice business;
- the drivers and opportunities for managing these costs; and
- the tools and guidelines necessary to select the system that works best in one's own operating environment and ways to manage the business within that environment.

STRATEGIC FRAMEWORK FOR SUPERMARKET FOODSERVICE

ANNUAL FINANCIAL PROFILE OF SUPERMARKET FOODSERVICE AT A STORE-LEVEL OPERATION

	COSTS ($000)	PERCENT (PERCENT)
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FOOD/INGREDIENTS	$196.1	55%
LABOR	99.6	28
SHRINK	7.5	2
OTHER COSTS	23.8	7
FIXED COSTS	28.7	8
COST OF GOODS	$355.7	100%
SALES	$780.0	100%
COST OF GOODS	355.7	46
GROSS MARGIN	424.3	54
FEATURE COST	42.4	5
MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

As supermarkets become more involved with the development and management of foodservice, they will require new ways of thinking about and managing these operations. The first question supermarket executives should address from a strategic point of view is: *"Why supermarket foodservice?"*

What is the role of the foodservice operation within the supermarket?

- To express the supermarket's image and responsiveness to existing customers
- To reposition or restage the supermarket chain to address new or emerging needs of existing customers or new customers
- To broaden the scope of the supermarket's positioning and offering to the customer—to complement the existing operation

RESOURCE COMMITMENT

The second set of strategic issues relating to building a foodservice business involves the resource commitment required to transition from a "grocery-operational model" to a "foodservice-operational model." This will involve change in the mindset of the organization.

Resources required are:

- executive time, dedication, and patience—"not a one-year strategy;"
- new human resource skills, experience, and acceptance within the organization;
- new and different business systems to accommodate the in-store value-adding processes—preparation, handling, merchandising, and customer service;
- quality control systems and procedures to ensure consistency and safety; and
- capital resources to create the "concepts."

The recommendation of the CCRRC:

Do not embrace a foodservice strategy unless you are willing to make the resource commitment.

STRATEGIC PROCESS FOR BUILDING SUPERMARKET FOODSERVICE

The process to create and operate a foodservice department is simple in the abstract, but complex in execution.

Each element of the process is described in greater detail on the following pages.

Strategic Process for Building Supermarket Foodservice Business

TARGET AUDIENCE AND OCCASIONS

The first step in developing a foodservice business is to determine:

- **Who is the target audience to be served? Who are the core customers who will sustain the business?**

The answer to this question will greatly impact the subsequent steps in the process. For example:

- **Is the target audience upper-income or mid- to lower-income?**
- **Is the system targeted at all day, all foods; or a rotating menu of offerings for certain meals and types of occasions?**

While the initial response will be to cast as broad a net as possible, foodservice experience suggests consumers do not believe any restaurant can credibly or competently meet *all* their needs *all* the time.

Therefore, choose, focus, and build credibility and trust!

CREATING A VALUE PROPOSITION

The next step is to determine the value proposition the supermarket foodservice represents to that targeted customer.

The value proposition includes those attributes that cause the consumer to choose "your" menu offering versus another option or choice. A value proposition is the essential reason for choosing supermarket foodservice over other options. It is normally based on a unique combination of elements shown below.

The proposition a supermarket develops and offers its customers should create and sustain demand at sufficient sales volume to support the infrastructure needed to execute profitably. ***This is then a profitable business.***

EXAMPLES OF A VALUE PROPOSITION

There is a wide range of value propositions a foodservice operation can design to create demand and sustain the business. Examples include:

- McDonald's—fast food with broad appeal, accessed quickly at a low price point
- Wendy's—fast food with adult appeal, accessed quickly at a moderate price point
- Old Country Buffet—vast assortment of foods at a value price (all you can eat) with seating for the family
- Ruth's Chris Steakhouse—steak experience that is sophisticated and at a high price point
- Boston Market—meals you might make at home, "to-go" or "eat here," convenient and moderately priced

Elements of a Value Proposition

$$\frac{\textit{Meal/Menu Recipe and Quality} + \textit{Variety} + \textit{Convenience of Accessibility and Use} + \textit{Ambiance/Theater} + \textit{Safety/Trust}}{\textit{Price}} = \textbf{Value Proposition}$$

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SOURCE: THE HALE GROUP ESTIMATES

The decision for each supermarket management team is:

- How do we want to be viewed and used?
- What is our point of difference?
- What is our competitive advantage?

CONVERTING VALUE PROPOSITION INTO FOODSERVICE CONCEPT

The value proposition is, in many ways, the "desired outcome" or how the customer views and uses the particular supermarket foodservice offering. The value proposition is also the essence of the business.

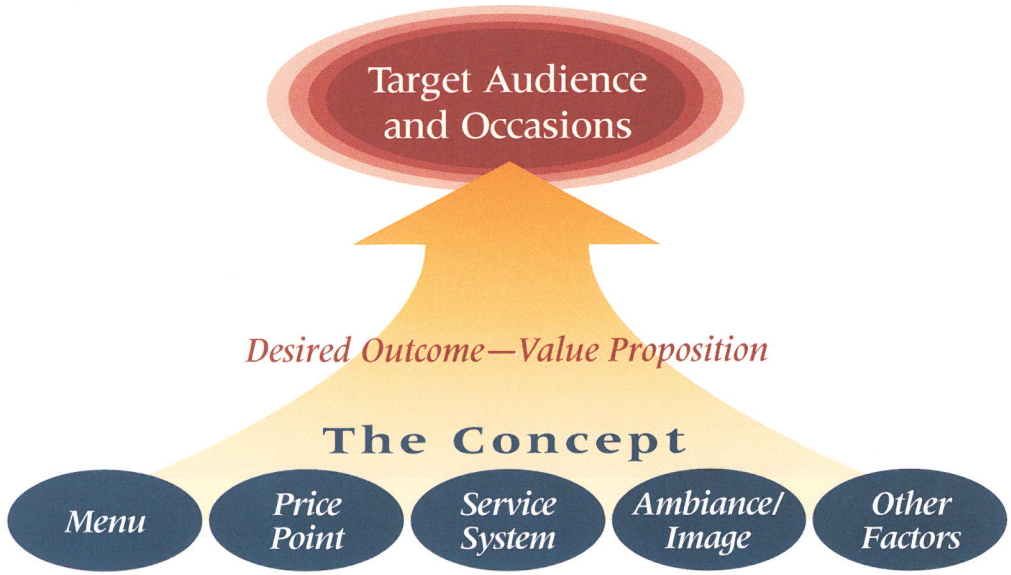
To deliver the value proposition, a foodservice concept must be constructed. The concept is, in many ways, the "product" that the supermarket offers to the consumer. However, the term "product" is too limiting in nature—a product is static and finite. A foodservice concept is dynamic and flexible/customizable to meet a broader range of occasions.

A foodservice concept is comprised of five elements.

CONCEPTS AND CONCEPT ELEMENTS

A foodservice concept can be differentiated and made unique by varying its elements. Each element is carefully modified and tailored by a specific operation to ensure the delivery of a satisfying foodservice experience to the consumer.

Linking Target Audience and Value Proposition to a Concept Development



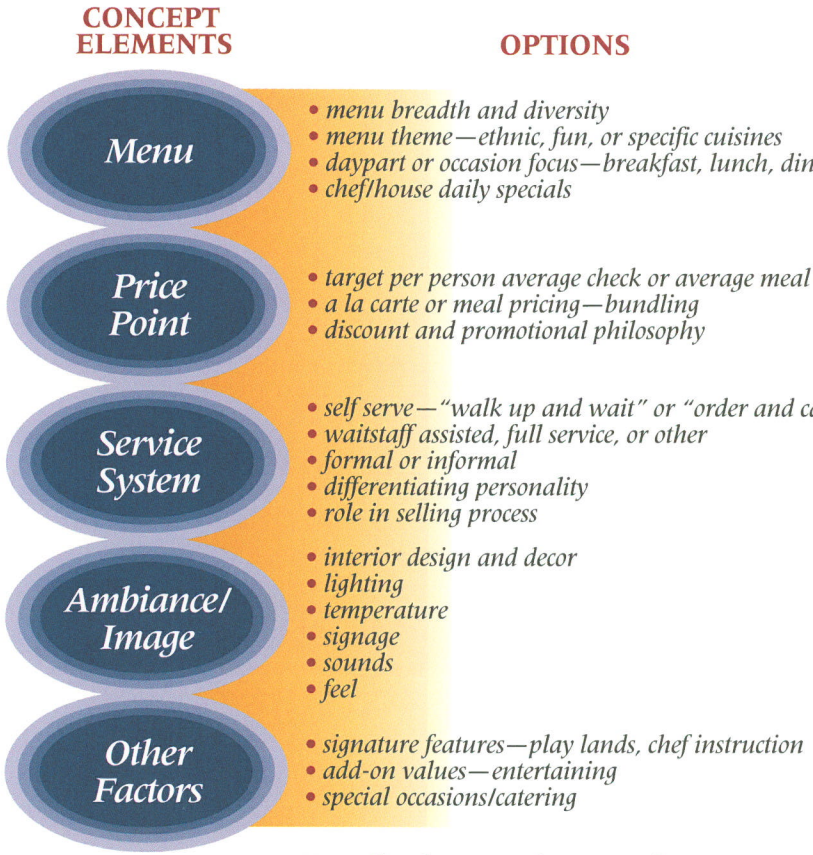
ASSISTANCE IN DESIGNING CONCEPTS

There is a wide range of resources available to assist supermarket management in designing a foodservice concept.

- Culinary—schools, publications, manufacturers (food and beverage suppliers), and trade association databases
- Design—trade association databases, equipment suppliers, consultants
- Restaurant chains or contract management firms—alliance partners

OPERATIONAL ENABLERS TO MANAGE CONCEPT

A foodservice concept is replicable in a consistent fashion via business processes and practices that represent the concept's operating systems. These have been dubbed—The Foodservice Enablers for Supermarket Foodservice.



Examples of Concept Element Options

DEFINITION OF AND RATIONALE FOR THE ENABLERS

The enablers allow the operator of the foodservice concept to manage the business so that the desired outcome for the customer is delivered, the integrity of the concept is maintained, the business is financially self-sustaining, and a return to stakeholders is provided. Each of these goals is achieved through the operating systems or enablers.

Standards and Product Specifications

To achieve consistent product/menu results at a predictable cost requires close control of inputs used in the process—ingredients and meal components, recipes/portioning, preparation procedures, and equipment used in the process.

Therefore…

- *Well defined product specifications are required; ingredients or products cannot be indiscriminately interchanged without changing the outcome.*
- *Recipes, yields, procedures, and equipment performance must be closely defined, communicated, understood, and adhered to.*

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Supply System

To achieve chain-wide consistency, a supply system or infrastructure must be in place.

- *Suppliers to the supermarket foodservice operation can, and should, assist the operator in co-creating demand and value.*

Therefore…

- *Develop strong working relationships with key suppliers and trading partners so resources are dedicated to and focused on consistent execution of the concept and continuous improvement of performance.*
- *Leverage the resources in the supply network—R&D, problem-solving, trend-tracking and analysis, new opportunity definitions.*

Organizational Design

To achieve consistent execution of the concept profitably and safely, tasks should be organized in a logical and efficient manner. Staffing to tasks and assuring desired outcome are the primary functions of on-site management.

Therefore…

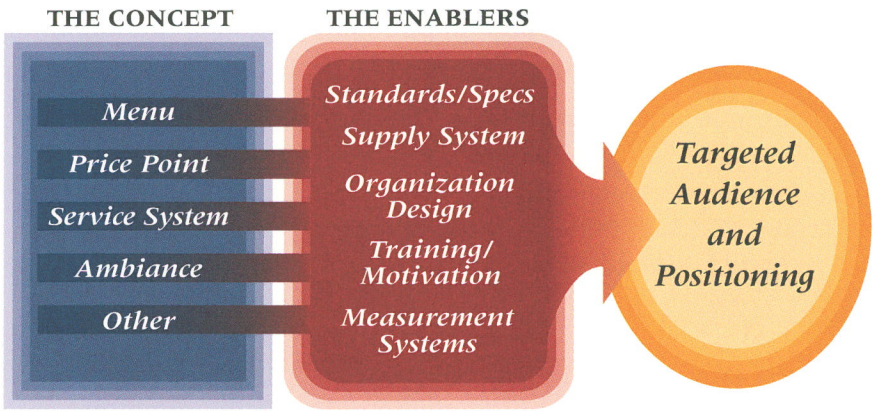
- *Organize work stations that focus on accomplishing a set of tasks rather than having staff move in inefficient patterns.*
- *Assign staff to specific activities or stations to balance the workload and to optimize the consumer experience. Customers will need more assistance in this setting than they would when purchasing a packaged good. Consumers also find some preparation activities more appealing than others.*

Training/Motivation

To achieve the desired outcome, the staff must understand expectations and be given the tools and knowledge to achieve those expectations.

Therefore…

- *Training must be on-going and extensive. Foodservice requires consistency of execution by a wide variety of less-skilled employees who turn over frequently.*
- *Motivational programs that focus the staff on achieving group goals have proven effective in traditional foodservice operations. A sharing of current versus desired performance in actionable time periods (hourly, per shift, daily) must become part of the operation's culture.*



Measurement Systems

To understand whether the concept is performing as planned/expected, tracking and measurement systems must be in place.

Therefore…

- *Information systems should be designed to monitor the demand, the fulfillment, and the costs; and areas that warrant attention should be flagged.*
- *Without measurement on an on-going basis, there is no way to manage the business and ensure success.*

COMMUNICATING THE CONCEPT

The foodservice concept in the supermarket must be communicated to current and potential customers.

Chain restaurant operators have learned that communicating with the customer drives the business by:

- communicating to the targeted customers the basic offering and the value proposition;
- informing the targeted audience how to use the foodservice concept—to-go, special occasions, call-in and pick-up, as well as other useful information;
- establishing the brand identity—core competencies and specific proficiencies; and
- promoting new and on-going specials or deals.

Given the vast range and number of meal options available to the consumer, on-going communication through signage, media, and community involvement is needed to put supermarket foodservice on consumers' "radar screens" at dinnertime.

SUMMARY OF STRATEGIC FRAMEWORK PROCESS

The strategic framework for establishing a successful supermarket foodservice business includes the following steps.

1. Identification of *target audience* and position
2. Determination of the *value proposition* that will be the base of the business
3. Creation of a tangible *foodservice concept* that consistently delivers the desired outcome for the consumer
4. Development and availability of *enablers* that provide operating systems to consistently execute the concept
5. *Communication* of the value proposition, the concept and how to use it, and the special deals being offered for the benefit of the current and potential customers

This is the strategic framework for management to follow in order to organize and operate the supermarket foodservice business.

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UNDERSTANDING AND MANAGING SUPPLY-SIDE COSTS

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SOURCE: THE HALE GROUP ESTIMATES

In the course of this study, it became clear that the two industries consider their costs and financial statements/measures in very different ways.

- Traditional foodservice operators consider their business using a systems approach, and hold on-site management accountable for controllable profit. This means that management is responsible for all costs of production and sales and for assisting in driving top-line sales.
- In contrast, supermarket operators/managers focus on sales as a share of the overall store. Managers work within the framework of the larger deli or even the whole store. Budgeting procedures and cost allocations covered in this study varied by company.

The CCRRC was instrumental in helping to develop a "hybrid P&L" that would be readily understood by supermarket management, yet more closely approximate the "foodservice view" of sales management, addition of value, and cost control. The P&L on this and the pages to follow is a result of that process.

The assumptions used to create the P&L used in this study are:

- overall sales of the supermarket per week are $500,000; and
- the foodservice department represents 3% of store sales.

Comparison of Supermarket and Foodservice Profit and Loss Statements

SUPERMARKET FOODSERVICE

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Source: The Hale Group Estimates

TRADITIONAL FOODSERVICE

GROSS SALES		100%
COST OF GOODS SOLD	35%	
FOOD		
BEVERAGE		
PAPER		
GROSS PROFIT		65%
LABOR COST	25%	
MANAGEMENT SALARY		
STAFF WAGES		
OVERTIME		
TRAINING		
BENEFITS		
CONTROLLABLE COSTS	15%	
G&A		
ADVERTISING/MARKETING		
DIRECT OPERATING EXP.		
REPAIRS & MAINTENANCE		
UTILITIES		
CONTROLLABLE PROFIT		25%
TOTAL FIXED COSTS	15%	
RENT		
TAXES		
INSURANCE		
OTHER OCCUPANCY		
NET PROFIT		10%

P&L STRUCTURE

In this "hybrid supermarket" P&L, costs were considered on two levels. The rationale was to allow supermarket operators to split their cost of operation between "production" and "selling." This, in turn, will allow managers to operate their businesses better.

- Traditional retailing involves purchasing and reselling a product in its same form for a profit. The better the *buy*, the larger the profit.
- In foodservice, profit is developed to a limited degree on the buy, and much more so on the addition of value; e.g., assembling ingredients, adding labor and creativity, and selling at an acceptable price. The greater the *added value*, the greater the profit.

The P&L is divided into two sections:

- Production Costs—fully allocated cost of ingredients, labor, equipment, supplies, etc., directly involved in production of the salable product regardless of site (in-store, commissary, or manufacturer)

The finished/salable product moves from production to sales at a known price, as the "cost of goods."

- Sales Costs—fully allocated cost of product, labor, equipment, supplies, etc., directly involved in the sale and maintenance of the product

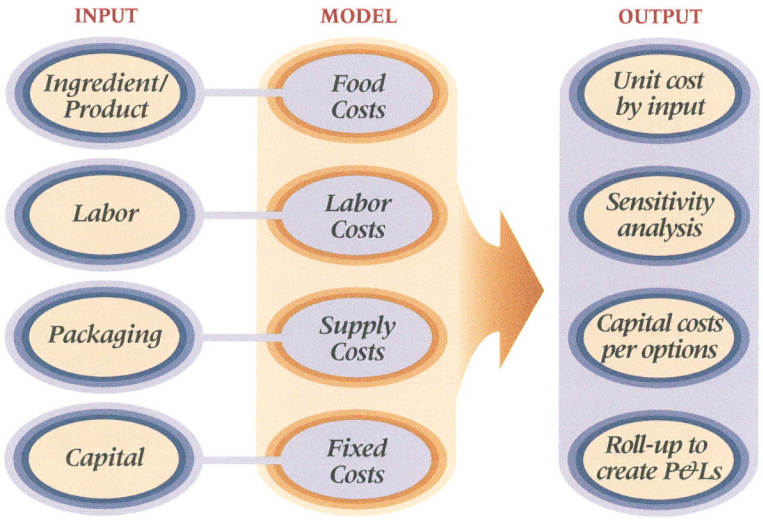
COST ANALYSIS MODEL/ROUTINE

The cost analysis for each menu item selected was modeled and analyzed as shown below. A computer-based model of the supermarket foodservice operation was constructed and data from the field research loaded into the model. The model was then used to consider the overall cost, sensitivity to various operating decisions, and as a basis for understanding cost-drivers.

IDENTIFICATION OF OPPORTUNITIES

There are two goals to understanding costs as they currently exist in the supermarket foodservice department: One—where are we? and Two—where could we be? The opportunities for improvement are based on understanding current operating practices in supermarket foodservice and gauging improvements that could be realized if foodservice *best practices*, i.e., those practices employed by successful multi-unit operators and contract feeders, were employed.

Cost Analysis Approach and Results



ANNUAL FINANCIAL PROFILE OF SUPERMARKET FOODSERVICE AT A STORE-LEVEL OPERATION

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PRODUCTION COSTS		
FOOD/INGREDIENTS	$196.1	55%
LABOR	99.6	28
SHRINK	7.5	2
OTHER COSTS	23.8	7
FIXED COSTS	28.7	8
COST OF GOODS	$355.7	100%
SALES	$780.0	100%
COST OF GOODS	355.7	46
GROSS MARGIN	424.3	54
FEATURE COST	42.4	5
MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

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MENU SELECTION/ PREPARATION CATEGORIES

Menu items chosen for the cost research and analysis were selected based on their category of preparation. Each of the fourteen menu items represents a category of like items with similar:

- production requirements;
- food safety characteristics;
- price point;
- holding characteristics;
- packaging requirements; and
- procurement options.

As mentioned previously, the analysis encompasses popular-priced items, primarily, but also premium-priced items—premium in terms of ingredients and presentation.

The menu items selected account for approximately 75% of the typical menu mix offered by supermarket foodservice operations nationwide, according to The Food Marketing Institute.

SOURCING/PREPARATION OPTIONS

The sourcing or preparation options considered in the study are defined as:

a. On-site Preparation or "Scratch"

Supermarket purchases ingredients and produces the menu item on-premise using recipes. This involves significant on-site labor and equipment but lower cost of ingredients. It also allows for the highest level of theater and customization.

b. Company-owned Commissary

Supermarket owns and operates the food production facility and distribution system. The store purchases fully prepared items, or components for assembly, from the commissary. Supermarkets with sufficient volume or scale to sustain a commissary are able to produce proprietary products in economically sized batches and maintain control of quality and consistency.

c. Shared Commissary

Supermarket purchases fully prepared food items, or components for assembly, from an independently operated food production commissary. Production and overhead costs are borne by the commissary, and a share of those costs (including profit) is allocated to the finished product. Shared commissaries provide an opportunity to prepare products in economic quantities, off-site, and share overhead costs with others to achieve lower overall costs.

d. Food Manufacturer

Supermarket purchases fully prepared food items or food components for assembly from a food manufacturer. These products are typically "off the shelf" but may be customized if there is sufficient volume.

SOURCING/PREPARATION CONSIDERATIONS

Factors that impact sourcing or preparation system selection involve:

- *sales volume* of a product or of the department; high volume makes on-site preparation a possibility;
- *role of foodservice operation*; on-site production creates a "culinary" image if executed correctly;
- *space availability*; on-site requires more space devoted to preparation in addition to the designated space for selling;
- *labor availability and skill level*; off-site preparation requires less skill, less labor;
- *systems and safety*; on-site handling must have monitoring systems for preparation *and* handling to achieve optimum safety margin; and
- *product complexity and degree of difficulty*; highly complex products, regardless of raw ingredient costs, require skills, time, and attention to detail.

Furthermore, it is clear that the sourcing or preparation decision must be considered on a product-by-product basis.

INTRODUCTION/DEFINITION

The first line item associated with production cost is entitled food/ingredient costs. This line item captures the raw materials used to create a finished product or component. The ingredients may be raw, such as fresh tomato; value-added, such as peeled potatoes; or convenience products, such as fully prepared pizza sauce.

CURRENT SITUATION

Based on The Hale Group's research, it appears that the major consideration in selecting ingredients and components is the price and not the overall cost impact of the selection. The food component or ingredient cost, while important, must be considered in the context of its impact on other costs, such as labor, performance, and waste.

Other cost-drivers include:

- yield characteristics, for example 6 × 6 tomatoes for sandwiches;
- batch sizes that are not matched to equipment capacity, e.g., five gallons of soup in a 40 gallon kettle;
- recipes that are not evaluated or crafted on an efficient basis; and
- raw materials that are too frequently viewed as interchangeable because they appear to be similar.

OPPORTUNITY FOR IMPROVEMENT

There are a number of ways managers of food production operations can improve the efficiency of their operations. These include:

- development of and adherence to strict product specifications; use two suppliers to ensure multiple sources of specified products, then restrict usage to these products, i.e., specify by brand, characteristics, and UPC number;
- constant evaluation of the end product with consumers and internal panels to ensure formulations and taste profiles are not drifting;
- supplier involvement in improving the performance of their ingredients in the preparation and delivery of the final product;
- frequent inventories of stock on hand to match with purchases and waste records in a formalized process; and
- on-going trade-off analyses between make versus buy; the buy may not be the entire finished product but rather major, pre-manufactured components that can be assembled at the store level.

TOOL KIT

The tools or processes that can be employed to achieve improvements are tied to understanding the impact of ingredients on the other cost elements in the preparation and delivery system.

Each recipe should be analyzed by the operator and the operator's major trading partners in a collaborative fashion. The goal would be to identify options to achieve the same end result at the lowest total system cost.

- Recipe evaluation based on the total cost of production, including labor and supplies, to determine the best cost scenario
- Manufacturer and wholesaler technical support
- Recipe and food cost management software
- Training on preparation techniques, product identification, and food handling—programs available from trade associations, manufacturers, and culinary schools

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INTRODUCTION/DEFINITION

The next cost in the production P&L is labor. This is the labor responsible for converting the raw materials into finished products or components. It is the second largest cost item in the production department and accounts for 28% of the cost of goods sold.

Labor is involved in receiving, storage, assembly, preparation, cooking, and, in some instances, portioning and packaging. The output of this labor component is a finished product ready for merchandising and sale.

CURRENT SITUATION

Labor involved in production is extremely important to the efficiency of the operation, and has a significant impact on the quality of the finished goods. Yet the labor force is often ill-equipped for the tasks involved in production. Undertraining as well as undersupervision can lead to waste and inefficiency.

Another practice that causes less than optimal performance is the rotation of labor into the foodservice production position from the deli or somewhere else in the store. This compounds the problem; labor is untrained and unfamiliar with the tasks at hand.

OPPORTUNITY FOR IMPROVEMENT

The current labor situation in many supermarket foodservice operations provides ample opportunity for improvement. For example:

- Production activities should be assigned to a set of staff that have, as their primary job description, food preparation. These staff members would have some level of education or experience as food preparation workers, thus, they would have basic skills and aptitudes for the relevant tasks.
- Initial and on-going training must be in place. Lack of training results in higher than acceptable waste, product inconsistency, and lower productivity. While training has a cost associated with it, the foodservice industry has learned it has a short pay back period.
- Hands-on supervision should be actively involved with production training, testing, and improving.
- Production should be scheduled, including related tasks, to ensure costs will approach budgeted goal.

TOOL KIT

As a means to improve the productivity and consistency of a production unit, the tool kit should include:

- Work stations should be designed to organize tasks, improve efficiency, and reinforce training.
- Videos of food preparation tasks are available from vendors and food associations such as National Restaurant Association, International Foodservice Manufacturers Association and Grocery Manufacturers Association.
- Recipe books and instructions, in a pictorial format wherever possible, are other tools to be used by the production staff. The operative word is "used" on a daily basis by the staff.
- Sales-driven and task-oriented scheduling software improves efficiency and lowers total cost.

The sensitivity of total unit cost is demonstrated in the following table. Higher labor rates or labor with low productivity can impact the cost of making a sandwich.

SENSITIVITY TO CHANGES IN LABOR RATES OR PRODUCTIVITY

	Cost Used in Study Model	*Sensitivity to Change in: Wage Rate*	*Worker's Productivity*
Labor Rate/Hour	$8.00	$9.00	$8.00
Production Minutes to Make One Sandwich	1.6	1.6	2.4
Food Cost	0.91	0.91	0.91
Labor Cost	0.21	0.24	0.32
Packaging Cost	0.02	0.02	0.02
Fixed Cost	0.15	0.15	0.15
Unit Cost for One Sandwich	$1.29	$1.32	$1.40

INTRODUCTION/DEFINITION

In the production P&L of the foodservice production unit, there is a cost line item for production shrink. This line captures the amount of raw material that is lost to spoilage, trim, or waste during the production phase of the operation.

In various supermarket foodservice operations, this line item varies in magnitude, but always exists. The most commonly encountered production shrink was 2% of production costs.

CURRENT SITUATION

The practice of budgeting in the P&L for shrink is not encountered in the foodservice industry. There is no line item for shrink, although that does not mean that waste does not occur in these operations. Waste is captured as part of a specific product and used to calculate the food cost of that specific product. The benefit, as viewed by the foodservice industry, is that waste or shrink is identified and can then be managed. The measure of food cost and expected yield are commonly practiced concepts in the foodservice world.

The concern with the current practice in the supermarket industry is that by budgeting for a 2 or 3% shrink, it becomes accepted and not managed to something less than that which is budgeted.

OPPORTUNITY FOR IMPROVEMENT

Shrink is not a cost line item that is generated by any one activity, but rather it is the result of many aspects of the operation. The opportunity to control and reduce shrink begins with measurement.

- **Measurement systems should be in place and able to capture the actual waste and compare expected return to actual usage. Management of shrink can then begin.**
- **Training has a great deal to do with shrink in an operation. Lack of training may be the single greatest cause of shrink in the supermarket environment.**
- **Menus should be developed that have a number of menu items using common ingredients, which aids in reducing spoilage and increasing inventory turnover, as well as improving quality due to fresher ingredients. This purchasing tactic is used by foodservice operators to reduce waste.**
- **There are a host of other shrink generators throughout production such as: poor product rotation, product spec not matched to usage, inadequate temperature control, and equipment that is not calibrated, as well as other factors.**

The major opportunity to reduce shrink is to not budget it as a line item, but rather to manage the food costs of each product produced and consider ways to improve yields realized from raw material and other inputs.

TOOL KIT

Tools to reduce shrink, as mentioned previously, start with a measurement system. These computer systems, called production management systems, are used in the foodservice environment. They tie raw material usage and yield together with the production schedule and results. The systems assist production managers to measure, forecast, schedule, and monitor operational activities and results of the department.

The second tool is training of the staff so that shrink is recognized and the staff recognizes there are ways to reduce shrink. For example, training materials, including videos and "train the trainer" programs, are widely available and can be adapted to suit individual needs.

Finally, management's commitment to not accept shrink as a cost line item will go a long way in reducing shrink. Timely dissemination of performance information is critical in getting "buy in" from the employees.

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INTRODUCTION/DEFINITION

The production line item "other costs" encompasses a number of different costs to include supplies, maintenance, packaging, smallwares, uniforms, allocated utilities, and other production-related variable costs. These costs, while only representing 7% of the production costs, have the potential to impact other costs. Specifically, maintenance is a cost on which to focus.

CURRENT SITUATION

The "other costs" category, as mentioned, has a number of different costs aggregated in one line. However, one of the costs that was identified as impacting the overall efficiency of the department was maintenance costs. In many ways, this cost is lower than it perhaps should be. Maintenance of the equipment and work area is critical to the productivity and efficiencies of the department. Properly maintained equipment and associated infrastructure have a direct effect on yields produced and costs generated. For example:

- calibration of equipment affects yield;
- cleanliness of hood and compressor vents affects cooking and refrigeration efficiencies; and
- preventive maintenance can reduce down time and "efficiency drift."

OPPORTUNITY FOR IMPROVEMENT

Opportunities for improvement involve maintenance as well as other cost elements in "other costs."

- Preventive maintenance represents a significant opportunity for improvement. The equipment and its performance impacts yields, efficiencies, and even whether a product can be produced. The foodservice industry recognizes the important role equipment plays in the overall production system and, thus, allocates resources to maintain equipment before it causes problems.
- Packaging of products in the production area is another area for cost management. Packaging should be functional as well as an aid in merchandising or transportation of products. There is a range of packaging options available that should be reviewed and evaluated for an individual operation to isolate which packaging is optimal for protecting and merchandising.
- Utility costs are driven by calibration, appropriate usage, and maintenance, therefore constant calibration and maintenance impacts other costs as well.

TOOL KIT

The first step toward managing "other costs" is to demonstrate to management of the supermarket organization the impact maintenance can have on the productivity and efficiency of the operation. To do this:

- encourage equipment suppliers to conduct an audit of the operation and identify areas for improvement and cost impact;
- create a preventive maintenance program for the foodservice operation; most supermarkets do not have foodservice-oriented preventive maintenance efforts; and
- train the staff working in the foodservice department to measure, calibrate, and use care when operating equipment.

Secondly, smallwares[1], uniforms, packaging, and utilities are costs that will inevitably occur. The degree to which they are controlled depends on on-site management.

- In foodservice operations, employees are made aware of these other costs and often encouraged to control them. Benchmarking such operations is useful in developing strong systems.

[1]Utensils, pots and pans, scales, etc.

INTRODUCTION/DEFINITION

The fixed cost line in the production cost section of the P&L is another of the lines with multiple costs captured in one place. Fixed costs of production are limited to amortized cost of the equipment that is dedicated to the production of food products in the department, and the allocated cost of space devoted to production.

The equipment capital cost used in this calculation is shown below.

CURRENT SITUATION

Several observations were made concerning the current approach to capitalizing the department with equipment. This study identifies how these approaches generate unnecessary costs.

- There is a tendency to overspend on equipment for the production department; overspending is due to purchasing unnecessary equipment or excess capacity.
- There is also a tendency to purchase a piece of equipment to produce, or be used for, only one food product. The rule of thumb in the foodservice industry is: "Do not purchase a piece of equipment unless it will have multiple uses, or it is to be used constantly for one product."

OPPORTUNITY FOR IMPROVEMENT

The opportunity to reduce costs associated with the equipment package used and the space devoted to foodservice production includes the following.

- Design the foodservice concept and menu before developing the equipment package. Equipment should be in support of the designated product rather than selecting equipment "just-in-case."
- Conduct a make-buy analysis before deciding what the equipment package should be. The concept will determine which products are signature products; management may want to produce these on-site with a bit of theater.
- Choose equipment that is versatile, easily maintained, and multi-functional.
- Select equipment that fits the expected task and volume of throughput.
- Practice preventive maintenance to extend the life of the equipment and ensure more efficient and dependable use.

Equipment is an integral part of the operation, but more is not necessarily better in this instance.

TOOL KIT

Equipment suppliers are expert in matching equipment to space and menu.

CAPITAL COSTS FOR EQUIPMENT REQUIREMENTS

Equipment Categories	*On-site Scratch*	*Assembly Only*[1]	*Capital Cost Difference*
Cooking Equipment	$59,150	$50,050	$9,100
Preparation Equipment	38,830	2,950	35,880
Storage	28,060	26,060	2,000
Other	30,167	17,600	12,567
Total	$156,207	$96,660	$59,547

[1]*Food/beverage sourced in finished or near-finished format.*

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INTRODUCTION/DEFINITION

Production costs associated with the supermarket foodservice operation depend on the sourcing option or combination of options supermarket management chooses. The degree to which management chooses to have on-site, "scratch" preparation impacts production costs. As shown below, the cost of on-site production versus sourcing products from outside commissaries or manufacturers varies these costs.

CURRENT SITUATION

Production costs are a function of the quality level targeted, the delivery system selected, skill level and direction of the staff, maintenance of equipment, and equipment package chosen.

Few supermarket foodservice operators have one production method for sourcing finished products for the foodservice operation.

OPPORTUNITY FOR IMPROVEMENT

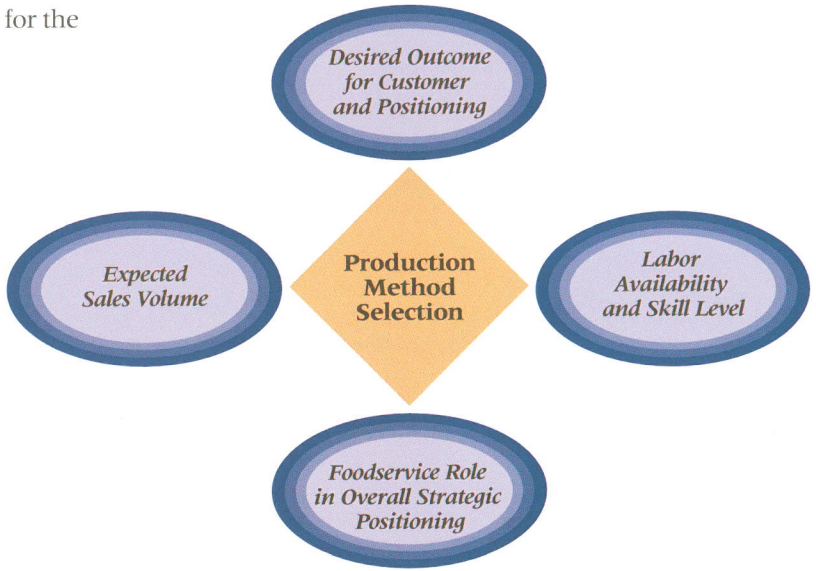
In supermarkets, as well as restaurants, "back-room" operations are combinations of on-site scratch and purchased fully finished from a manufacturer. However, there is normally an overall approach to production or food preparation that defines the operating model, and the basis of the sourcing model. There are variations on a system or operating model. For example, the operating model may use manufacturer finished goods but would prepare signature leaders or products core to the concept from scratch. Other products in this example would be sourced from off-premise production centers.

The optimal solution begins with the end-in-mind, i.e., the "desired outcome" that management envisions for their customers—the concept delivery.

- A culinary experience or family-oriented meals
- Premium-priced or value-oriented
- Statement of competencies around a defined set of products, or a general image as a provider of consistent quality at a value

These positioning issues are further shaped by sales volume expectations, labor availability and skills, and the role of foodservice in the overall supermarket strategic positioning.

Selection of Production Methods



INTRODUCTION/DEFINITION

The sales volume of supermarket foodservice as defined in this study included prepared foods of restaurant quality sold through a supermarket foodservice department. This includes the fourteen items in the appendix plus other products sold in the foodservice department that are prepackaged items (manufacturer-packaged items). It does not include the salad bar or sliced meats and cheeses traditionally sold in the in-store deli department.

CURRENT SITUATION

This study focused primarily on the cost of producing and merchandising/selling meals and products through the supermarket foodservice department. As the study progressed, it became evident that cost alone is only one factor affecting profitability. Other non-cost factors and, in this instance, sales-related factors are:

- **sales volume of the foodservice department;**
- **mix of products sold in the department;**
- **pricing of products and establishing an enhanced value for the products; and**
- **merchandising/marketing of the department and key/signature products.**

The results of this study determined that top-line issues are as critical to success, as the management of costs and bottom line issues.

OPPORTUNITY FOR IMPROVEMENT

Opportunities to improve the top-line, i.e., sales of a foodservice operation and/or improve the profitability of the operation by adjusting the sales mix, should be thoroughly explored by management of supermarket foodservice operations. While there are many marketing issues and factors, convenience issues and factors, as well as other factors that affect sales, this study has selected three areas to discuss as opportunities.

1. **Value Enhancement**
2. **Bundling and Meal Solutions versus Product Selling**
3. **Menu Mix Engineering**

Each of these opportunities to improve gross profit is discussed in further detail.

1. Value Enhancement

Foodservice menus, meals, and products are created and merchandised as proprietary products that are differentiated from other competitive offerings. The objective is to:

- **create an image of value (at the appropriate and desired price point);**
- **establish a point of difference so comparative shopping is difficult to do; and**
- **institute branding so even the name of the product or meal stands alone—unlike others.**

Competing on a commodity or price basis erodes value and confidence/integrity of the price. For example, a Big Mac priced at 99¢ for a month established a price/value expectation of 99¢ even after the promotional period.

As shown on the following page, supermarkets generally sell rotisserie chicken as a commodity product versus a differentiated product. Therefore, they sell by price. Conversely, Boston Market's Rotisserie Chicken, marinated and rubbed, and Kenny Rogers Roasters Wood Fire Roasted Chicken, are differentiated products.

ANNUAL FINANCIAL PROFILE OF SUPERMARKET FOODSERVICE AT A STORE-LEVEL OPERATION

	COSTS ($000)	PERCENT (PERCENT)
PRODUCTION COSTS		
FOOD/INGREDIENTS	$196.1	55%
LABOR	99.6	28
SHRINK	7.5	2
OTHER COSTS	23.8	7
FIXED COSTS	28.7	8
COST OF GOODS	$355.7	100%
SALES	$780.0	100%
COST OF GOODS	355.7	46
GROSS MARGIN	424.3	54
FEATURE COST	42.4	5
MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

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SOURCE: THE HALE GROUP ESTIMATES

Based on the cost analysis conducted in this study, the gross profit results are markedly different.

Branded foodservice providers are achieving gross profit levels for rotisserie chicken of $1.00–$2.50 while supermarket foodservice is achieving a gross profit margin of $1.00 or less. Value enhancement can go a long way to improving profitability.

2. Bundling and Meal Solutions versus Product Selling

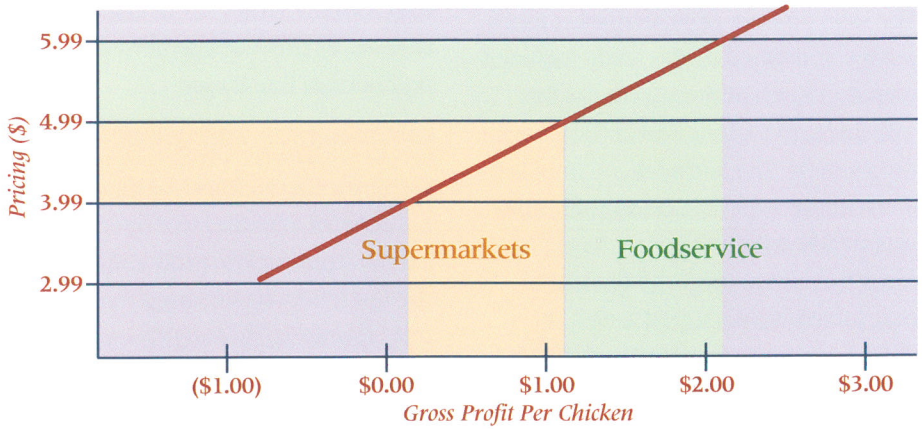
The foodservice industry has long recognized that controlling the mix of products sold impacts the overall profitability of the restaurant. Ideally, restaurants would sell soft drinks, French fries, and/or alcoholic drinks because of their high gross profit and cut out all other products. Of course, this would not represent a "value proposition" for the consumer seeking a meal solution.

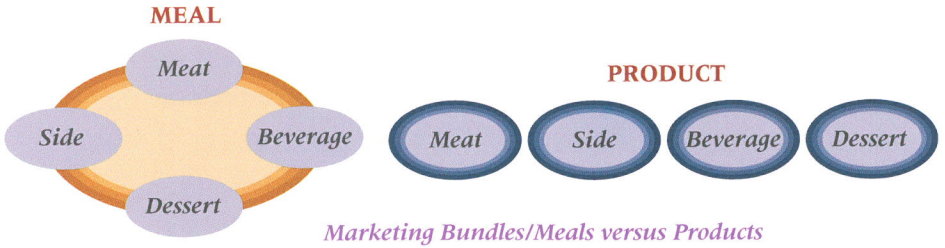
However, one strategy used by the foodservice operator to manage the mix is bundling, e.g., bundling an assortment of foods and beverages together to create a meal versus selling the menu items as separate products.

3. Menu Mix Engineering

The design of the menu is critical to generating sales and profits. This topic is explored further on page 29 of this report.

Rotisserie Chicken: Price versus Gross Profit





Marketing Bundles/Meals versus Products

Foodservice concepts depend on selling a bundle of products that comprise a meal.

Product Category	*Food Cost/ Gross Margin Status*	*Gross Profit Margin*
Entree	*high food cost; lower gross profit*	35–40%
Side Dish	*moderate to low food cost; moderate gross profit*	60–65%
Beverage	*low food cost; high gross profit*	50–90%
Desserts	*moderate food cost; moderate gross profit*	45–50%
Bundled Meal	*value pricing and attractive gross profit*	60–70%

INTRODUCTION/DEFINITION

The features cost line represents budgeted discounting or promotional activities. These are preplanned promotional and discounting activities versus markdowns, discussed on the following page, which capture unplanned discounting.

The features line in the P&L captures the difference between the normal price of a product on feature minus the discounted/promotional price while on feature.

The cost of advertising the featured product is captured in the advertising line item of the P&L.

CURRENT SITUATION

The feature is a program designed by supermarket foodservice management. The question that should be asked vis à vis current feature creation and implementation is: "Are we driving the business hard enough with our current approach?" Is there a measurable payout associated with current "feature" practices?

The feature is frequently designed and implemented in the same manner the grocery chain/store would use for a box of cereal. The "feature" for foodservice does not currently describe in a "selling" fashion the meals or products being offered. There frequently is no selling of the value being added in the store.

OPPORTUNITY FOR IMPROVEMENT

The current practice in supermarkets is largely to discount products rather than to create trial/other value-enhancing methods. The foodservice industry has reverted to discounting products, in many instances. However, experience in foodservice suggests discounting reduces the long-term value of a product by establishing a new, lower price point expectation.

Among the other methods/practices used to drive a feature/promote a product are:

- **bundle with other products, e.g., a free side with a rotisserie chicken or a free drink (soft drink, tea, juice) with a pizza or sandwich; or**
- **use an event promotion that is tied to a national, regional, or local event—sport teams, movies, other special events; provide discounted tickets or passes.**

Promotional activity is a major driver of sales. The use of high impact, low cost promotions is the goal.

TOOL KIT

Ultimately, a marketing effort will be required to address and support the supermarket foodservice department. The tool kit must, at some point, include a marketing resource that understands foodservice operations, the target market, the value proposition/desired customer outcome, and marketing principles.

Marketing is a mainstream function in every successful foodservice operation.

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INTRODUCTION/DEFINITION

Markdowns/selling shrink is a major, non-value-adding cost component in the supermarket foodservice P&L. Markdowns/selling shrink account for 11% of the operational scenario created for this study. Actual shrink observed in the market ranges from approximately 5–15% of a department's sales.

Markdowns/selling shrink is generated primarily by finished products that are outside the quality limits established or are approaching a shelf-life and product age that is beyond what supermarket management deems acceptable.

Markdowns are the activity of lowering prices significantly to move the product rapidly. Selling shrink is associated with spoilage and throw-aways.

CURRENT SITUATION

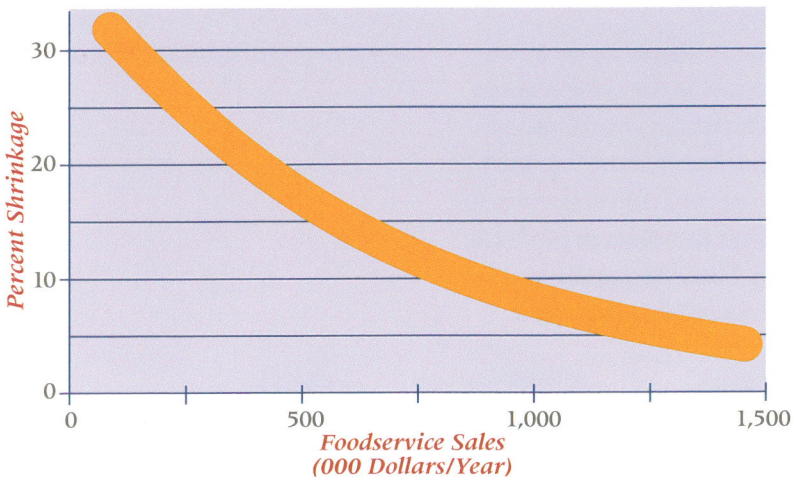
Markdowns/selling shrink represents a significant negative impact on supermarket foodservice departments. The 11% shrink identified in the study represents approximately $85,000/year/store. Furthermore, The Hale Group is concerned since the actual markdown or shrink measurement systems are crude at best, and given that selling shrink is a budgeted number, the shrink may be understated.

Markdowns/selling shrink is generated by a number of factors today. Among the factors isolated in this study are:

- lack of adequate information systems designed for, and available to, the store's foodservice manager to track production, develop forecasts, and measure loss contributors;
- offering a broad range of products all day without segmenting the days and dayparts into menu demand;
  - *not aligning stocking to traffic patterns*
  - *holding product in larger than needed quantities, not in accord with traffic patterns*
  - *stocking once or twice a day and then selling all day*
- election of inappropriate production method or bulk packaging—number of portions per bulk pack versus shelf-life versus the sales volumes realized and/or anticipated; "oversize production for underdeveloped sales;" and
- inadequate training and supervision of staff so product in display cabinets is not monitored and rotated as frequently as required.

The shrink issue in supermarket foodservice is a strategic issue and currently problematic. The attraction of a supermarket foodservice operation, for the consumer, is the broad range of solutions offered and, thus, the variety. However, the drawback of the supermarket foodservice operation is that variety in the department generates too many products without sufficient value per product to sustain turns and, thus, the desired quality.

Estimated Shrink versus Sales Volume



OPPORTUNITIES FOR IMPROVEMENT

There are opportunities to manage the selling shrink and reduce the need to mark down products using foodservice tools, practices, and guidelines. Specifically, restaurants tend to focus on defined traffic periods, therefore, gear the operation, i.e., staff and preparation, to meet those surge periods.

Nonetheless, there are operational and menu strategies to reduce waste—shrink and markdowns.

1. Measurement

This solution was discussed in the production shrink section of this report, therefore, those management strategies will not be reiterated in this section.

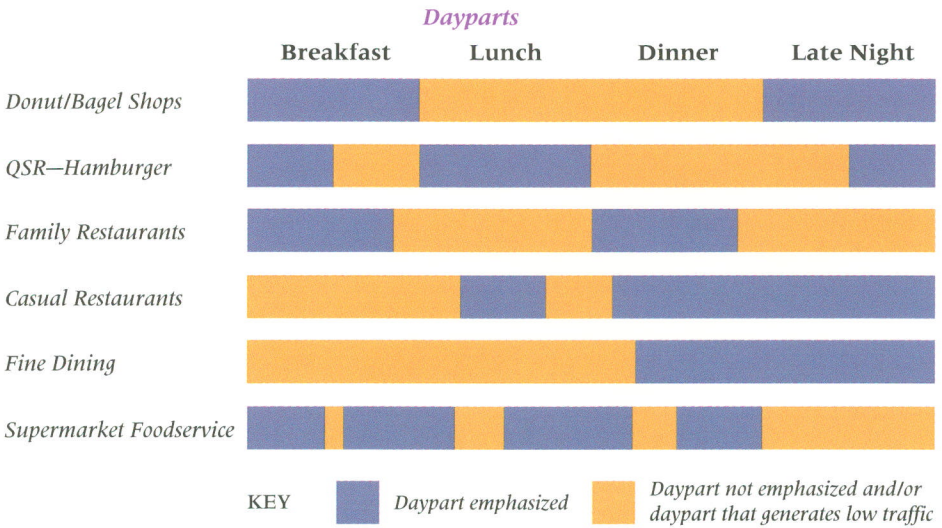
Sufficient to note that the first step in reducing the selling shrink and markdown requirement is to measure it and understand it.

As mentioned previously, back-room management systems are needed that will track sales by time and by product; yield in the back door to sales through the case, by product; and "smart" forecasting tools, since many systems today can develop and adjust forecasts based on on-going input.

2. Menu and Merchandising Management

Foodservice operators want to achieve the same goals as supermarket foodservice operators in terms of having the correct assortment/variety at any given time to most efficiently meet the customer's needs. However, variety and operating economics must be balanced. The technique to balance variety and economics:

- Purchase or store products in packaging or conditions that extend the shelf-life and in package sizes that have the correct number of portions for the store traffic—extended shelf-life products in optimum portion/package lots.
- Establish a core product offering—all-the-time, everyday—and establish a rotation menu—specific products available on specific days. (Support rotation with a customer communication program to inform the customer of the rotation menu.)
- Develop and adhere to menu item maintenance guidelines:
  - *product must represent at least 5% of sales to hold a menu position; or*
  - *sales must meet a pre-established sales level to maintain distribution in the foodservice department.*
- Increase stocking and freshening of the merchandise case and create the illusion of bountiful stock through merchandising techniques.
- Staff to traffic when possible versus level staffing patterns that are the norm in the supermarket industry today.



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3. Training and Supervision

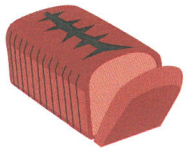
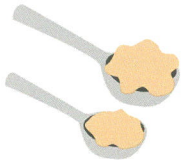
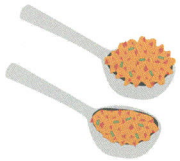
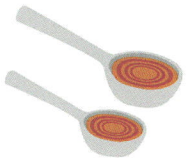
Still another basic element to reduce waste and shrink is training. Training would include:

- use management systems and information provided to stock to traffic/sales patterns;
- rotate product on a regular and regimented basis; and
- employ portioning and realize the impact of portioning on food cost and shrink.

Controlling portion size directly impacts food cost and shrink. An example of the impact of portioning on shrink is shown in the exhibit.

If there are, on average, 100 sales per day, the misportioning of this one meal translates into an additional $18,616 annually.

EXAMPLE: MISPORTIONING COST IMPACT

	Food Cost/oz.	*Required Portion*	*Actual Portion*	*Net Loss ($)*
	$0.08	*16 ounces*	*17 ounces*	($0.08)
MEATLOAF				
Meatloaf is improperly cut into 7 portions (14 slices), a net loss of 1/2 portion.				
	$0.03	*4 ounces*	*6 ounces*	($0.06)
MASHED POTATOES				
Wrong scoop size used for portioning resulting in an added 2 ounces.				
	$0.07	*4 ounces*	*5 ounces*	($0.07)
STUFFING				
Due to clumpy texture, product not properly measured in scoop.				
	$0.15	*4 ounces*	*6 ounces*	($0.30)
GRAVY				
Wrong ladle used to measure gravy resulting in an added 2 ounce portion.				

Total Net Loss Per Meal: ($0.51)

INTRODUCTION/DEFINITION

Selling labor costs are defined as those costs associated with the merchandising and selling of finished products to supermarket foodservice customers. Selling labor is responsible for the handling associated with transferring products from production to the merchandising/display cases or shelves; stocking and merchandising display maintenance; interfacing with customers and taking orders; preparing, packaging, and pricing orders; and resolving customer problems when they arise.

Merchandising of finished products may be an active task as in carving stations.

Selling labor cost is estimated to be 25% in the chosen scenario—20% labor cost and 5% benefits cost. It should be noted that labor cost varies in the supermarket industry. An $8.00 per hour labor rate was used in this scenario.

CURRENT SITUATION

Selling labor is a critical element in the supermarket foodservice concept since this is the point at which the customer and the concept interact. The experience of the customer is established at this point.

Selling labor's productivity and effectiveness are affected by a number of factors, such as:

- skill level established by training, experience, and supervision;
- organization of the service system and work space—has the service area been designed to assure efficiency of service;
- organizational design so tasks are assigned to a specific individual rather than to a team that undertakes all tasks; and
- training on products—knowledge of products, ingredients, benefits, and natural combinations; suggestive selling and solution selling.

The study identified the lack of organizational design for the foodservice department in terms of segmenting activities and tasks associated with a service system and then creating job descriptions and expectations.

OPPORTUNITY FOR IMPROVEMENT

Selling labor can influence the speed of service, the number of items purchased, and the overall customer experience. Selling labor is the human content of the concept from the customer's vantage point and, thus, selling labor determines the way the concept performs for the customer and ultimately, customer satisfaction.

Possibilities to enhance profitability from a selling labor standpoint include the following.

- Review the service system and ensure design allows for the optimum experience for the customer—efficient, timely, and pleasant service experience that provides the solution the customer wants and needs.
- Establish an organizational design that has service staffing as a designated position. Currently, the service staff, in some of the supermarket foodservice operations, are randomly assigned to the foodservice service system. This impacts the quality of the experience, and the efficiency of the system.
- Train the service staff on their roles, expectations of them in serving customers, ways to suggestive sell, and selling meals (proper mix) versus product selling.
- Provide training and supervision on how to rotate product, freshen the merchandising of products, and portion products.

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TOOL KIT

To assist in reviewing and improving service systems and training of selling labor, the following resources and processes can be employed.

Service System Review and Improvement

- Foodservice consultants; design consultants
- Universities with foodservice programs
- Literature on service systems from Harvard Business School, Cornell University School of Hotel Administration, Michigan State University School of Hotel, Restaurant, and Institution Management
- Auditing a broad range of existing best practices in the foodservice industry from QSRs to cafeterias to new market concepts

Training the Selling Labor

- National Restaurant Association training videos and programs
- Restaurant industry trade magazines, in several instances, offer programs
- Training programs from foodservice and beverage manufacturers that cover not only their products, but also generic topics such as selling skills for waitstaff/servers
- Universities and foodservice training consultants

Scheduling Systems

- Labor scheduling programs are available from foodservice "back-of-the-house" system providers. The desire is to have labor scheduled hours consistent with the sales/traffic patterns.

INTRODUCTION/DEFINITION

Training costs capture the cost of training staff assigned to the supermarket foodservice department. Training currently consists of on-the-job training as a deferral of labor costs during the learning phase. It also includes off-site training for safe food handling and other seminars/training sessions on general administration procedures required by supermarket operations. Training costs in the industry currently are approximately 1% of sales.

CURRENT SITUATION

Training is one of the least developed business practices. According to research undertaken in this study, training has not been a major tradition in the supermarket industry. On-the-job training and transferring skills from supervisors to new employees have been the operational model.

There is little evidence of investment in the development and ongoing use of training materials and programs relevant to the tasks of the foodservice staff.

Moreover, there is currently little evidence throughout the supermarket industry of an appreciation for the importance of foodservice training as *the* cornerstone of consistent and efficient execution of the foodservice concept.

Training or the lack of training is estimated to have a 5–8 percentage point impact on an operation, i.e., to affect the bottom line performance by 5–8 percentage points.

For the scenario identified in this study, this would mean a 3–6% profit margin, rather than a 2% loss, as a result of proper training.

OPPORTUNITY FOR IMPROVEMENT

As mentioned previously, the impact of training is significant in a foodservice operation.

Training in a service concept is the difference between success and failure. In a foodservice environment, the concept is dynamic and requires labor to provide the appropriate level of service and experience. Therefore, training will improve the performance of the concept by:

- assisting in building the sales volume through consistent execution of the concept;
- controlling costs by reducing shrink and increasing productivity; and
- improving profitability by helping to manage the sales mix.

ESTIMATED IMPACT OF TRAINING ON NET PROFIT

	Department ($000)	*Net Profit (percent)*
Current Profitability	($19)	(2%)
Anticipated Impact of Training	39–70	5–8%
Anticipated Net Profit	$20–51	3–6%

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MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

The experience in foodservice is that training is a mainstream activity supported by:

- training manuals and programs for new employees who have a multi-week work-study program; managers responsible for monitoring against the program and coaching when necessary;
- training video library and video player in the employees' break-room; used for mandated on-site training sessions;
- instruction programs, on-site or off-site, or regional meetings that are annual or semi-annual;
- vendor sponsored training sessions on new products or a new marketing program to be implemented by the foodservice operation; and/or
- supervisor training in concept evolution and annual programs; also training in coaching and supervision to ensure the concept is efficient and producing at a high level.

Training coupled with testing is central to the success of a concept. A high percentage of foodservice operations fail because of poor or inconsistent execution of a well-thought-out training program. Training is one of the key tools to ensure proper execution. Research shows that employees want to be successful but need the tools to do so.

COMMITMENT ISSUE

Training is often viewed as a soft function in an organization. However, the linkage between training and performance is seldom measured; therefore, when budgets must be managed to meet "bottom line" expectations by year end, training budgets are among the first to be cut.

Training must be an area of commitment by executives. Training is linked directly to performance and success. Training is a cornerstone function in foodservice.

TOOL KIT

The training function is a key organizational component of the foodservice business. Training is one of the five foodservice enablers, supporting efficient and consistent execution. Therefore, investment is warranted.

The tool kit should include:

- recognition in the organization and in the budget that training is a commitment of the supermarket executives;
- training programs created and implemented to address basics such as food handling and safety, as well as concept-specific areas, i.e., preparation, merchandising, and selling/servicing; and
- management development through foodservice seminars and conferences to increase knowledge and build a network—National Restaurant Association Restaurant Show, International Foodservice Manufacturers Association COEX Program, Food Marketing Institute Meal Solutions Conference.

The first step in building a training function is creating awareness within the organization at all levels that training is a key to success in foodservice.

INTRODUCTION/DEFINITION

Other controllable costs are a composite of costs associated with the selling operation. These are costs controlled by the unit/store management; they are other than food or labor costs. This line item is approximately 5% of sales and includes: packaging materials, supplies such as cleaning supplies, smallwares, utensils, and uniforms. The major components are packaging and supplies, representing in excess of 90% of this line item cost.

CURRENT SITUATION

Supermarket foodservice operations currently view packaging as a functional, "must have" item in the operation. However, during the research it was observed, in many operations, packaging was approached as a less than critical element of the concept/operation, and quite the opposite is true.

Packaging is a cost of operation, but also impacts the cost of other aspects of operation. For example, based on the research, the following observations were made.

- Packaging was evaluated on a functional and cost basis, not as a selling and branding opportunity.
- In order to control costs, one package would perform multiple tasks. In some instances, the package was oversized for one or more of its uses and resulted in either the perception of underfill and poor value, or resulted in overfill and "give-away."
- Packaging was not consistent with the concept, i.e., there were instances when premium packaging was used in a price-driven foodservice concept; in other instances, commodity packaging was selected for a more upscale concept.
- Packaging as an integral element of the concept to build the brand, provide instruction, and differentiate the concept is not a widely accepted practice.

The other major components of the "other controllable" costs include cleaning supplies, uniforms, and smallwares. These are cost generators that should be controlled and managed. Current practices observed in supermarket foodservice were reasonable though there is room for improvement.

OPPORTUNITY FOR IMPROVEMENT

The other controllable costs, both packaging and supply components, can benefit from a revisit by management.

For packaging improvement opportunities, it is suggested management consider three areas.

1. Packaging as an integral element of the delivery system and concept
   - *Packaging that reflects and reinforces the positioning of the concept—value-oriented, family or midscale-oriented, or upscale-oriented*
2. Packaging that aids portioning and portion control and, in so doing, creates a sense of value—"sized for the task"
3. Packaging that is a brand-building tool providing a "billboard" for communication, i.e., is part of the overall concept and business development efforts

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Packaging has multiple tasks and all should be part of the evaluation and selection process. Packaging should not be an after-thought since it represents the concept and the brand to the supermarket foodservice customer. Therefore, consider:

- branding and differentiation—marketing and demand creation;
- functionality and convenience—consistency and marketing quality;
- heatable package or requiring transfer to a heat-safe package/container; and
- instructions and access—information conveyance.

TOOL KIT

Tools to manage packaging costs and use are tied to initial rigorous evaluation against concept criteria and maintenance of the adherence to standards—right package used for right product and portion.

Resources are packaging companies, as well as food manufacturers with extensive foodservice customer base and knowledge.

PACKAGING COSTS AS PERCENTAGE OF SELLING COST FOR SELECTED ITEMS

	Average Packaging Cost in Supermarket Foodservice	
Products	*Cost/Unit*	*Percent of Selling Price*
Meatloaf	$0.20	4.2%
Sides	0.15	6.5
Soups	0.19	4.9
Pizza	0.43	5.7
Rotisserie Chicken	0.31	6.2

INTRODUCTION/DEFINITION

The advertising line item in the supermarket foodservice P&L captures costs associated with marketing activities of the department. These costs are generally in support of "features" or newspaper inserts or, in some instances, "sampling costs" for in-store demos. This cost represents <1% of sales in the scenario created for this report.

This line item does not capture any allocation of general or corporate advertising a supermarket chain might undertake.

CURRENT SITUATION

The foodservice department needs to have sufficient volume to support the infrastructure of a foodservice operation and to ensure product turnover so quality is maintained and shrink levels reduced. Currently, the feature program is less than a budget that would be sustained in a "start-up" foodservice operation.

- Establishing an identity for foodservice
- Communicating the value proposition to the customer
- Creating trial with existing and new customers

These are the work of the "feature" line item.

The current budget and/or application of the budget is viewed as insufficient to position supermarket foodservice as a preferred meal solution option. The effort supported by this budget must overcome customers' existing shopping patterns; and undertake the task of changing the supermarket's image and establish supermarkets as the source of "freshly" prepared meal solutions for the next millennium.

OPPORTUNITY FOR IMPROVEMENT

Supermarket foodservice departments must stimulate use in order to drive sales. Sales growth will improve the efficiencies of the operation and generate more market dollars, as well as drive sales "harder." The foodservice industry uses a broad range of techniques to drive sales that include, but are not limited to:

- advertising—electronic and print media to stimulate sales and build the brand image;
- signage—"on the street" (part of a build awareness program) as well as in-store to promote and/or attract new occasions and new or underdeveloped customers;
- billboard signage—provides direction to the outlet/store and establishes the brand image;
- event marketing—creating special events to generate excitement and involvement with the brand and with a trial;
- promotional campaigns—coupons, deals, premiums to attract new customers and/or reward existing customers for on-going use; and
- public relations—campaigns, events, involvement to heighten awareness and visibility in the community/trading area, and reinforce the image by association with select groups, activities, or events.

The budget for features may be one the supermarket foodservice participants will increase during the transition period from grocers to grocer-foodservice operators. A budget in the range of 7–9% may be required.

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INTRODUCTION/DEFINITION

The maintenance line item in the P&L captures the cost of repairing and maintaining foodservice equipment. This cost includes the labor and supplies of internal resources devoted to such tasks, as well as external suppliers of services. The current level of repair and maintenance of the selling and merchandising aspects of the operation are approximately 1% of sales or $8,700 per store per year in the scenario created in this study.

There are other repair and maintenance costs captured in the "production costs" section of the P&L, which are discussed on previous pages of this report.

CURRENT SITUATION

Activities that comprise repair and maintenance affect the efficiency and costs of other parts of the operation.

- Calibration of equipment impacts the level of shrink or loss. Incorrect or inadequate temperature control determines the shelf-life and safety of foods.
- Proper operation, or amount of down time, of equipment can create waste, shrink, and/or loss of sales.
- A positive working environment is fostered by equipment that is in good repair.

Currently, there is less attention devoted to preventive maintenance and rapid response repair than would normally be encountered in the foodservice industry.

OPPORTUNITY FOR IMPROVEMENT

The supermarket foodservice operation should have established preventive maintenance programs and a repair service that is on-call 24 hours a day.

The preventive maintenance program would include:

- inventory of parts and service;
- preventive maintenance schedule for equipment and work stations; and
- records of maintenance conducted and identification of weak links in equipment.

The repair service may be internal or external. The important characteristics of the service are competence, cost, and rapid response.

- Repair service familiar with the equipment and with trained service agents, as well as parts on hand
- Repair service that understands the need for urgency in dealing with repair problems because of safety, efficiency, and sales loss issues involved with perishable products

The repair and maintenance budget observed in the supermarket foodservice business is less than would be experienced in the foodservice industry. It may be that less effort is devoted to this task than is required to:

- maintain the delivery of a consistent quality product and service experience for customers; and
- aid in reducing the amount of shrink realized.

Twin Approach to Maintenance and Repair

INTRODUCTION/DEFINITION

The fixed costs captured by this line item are depreciation or amortization of the equipment associated with the selling section of the foodservice department and rent for the space allocated to the selling section. Equipment that is amortized and supporting the selling effort is noted in the appendix. The selling fixed cost amounts to 4% of sales in the scenario developed for this report.

CURRENT SITUATION

The selling fixed cost is currently driven by two factors:

1. The amount and expense of the equipment devoted to the selling process. This, for the most part, is display equipment, particularly refrigerated cases and selling/work station equipment—tables, shelving, and associated refrigerated storage.
2. Space devoted to the selling section, i.e., square footage as determined by supermarket management.

In each of these cost areas The Hale Group's research revealed, in a number of cases, over-commitment to equipment and space.

Findings that emerged once the capital costs were analyzed were the facts that:

- the single largest capital cost in the supermarket foodservice operation is selling and merchandising equipment; and
- preparation equipment required to prepare most items on-site versus prepared off-site and only assembled and displayed on-site represents only a 19% increase in capital commitment.

The space allocated to selling and, thus, the resulting occupancy cost or rent is currently observed to be inefficient. Among the inefficiencies noted:

1. the amount of space devoted to the selling operation; and
2. organization of the space so employees have to walk or traverse complex traffic patterns in an effort to assemble and prepare an order for a customer.

CAPITAL INVESTMENT BY SOURCING OPTIONS: INVESTMENT FOR ON-SITE VERSUS OFF-SITE NOT SIGNIFICANTLY DIFFERENT

Fixed Costs Components	*On-site Scratch*		*Commissary/ Manufacturer*		*Difference*
	($000)	(percent)	($000)	(percent)	($000)
Storage	$28.1	7.4%	$26.1	8.2%	$2.0
Preparation	128.1	33.8	70.6	22.1	57.5
Selling/Merchandising	222.8	58.8	222.8	69.7	0.0
Total	$379.1	100.0%	$319.5	100.0%	$59.5

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OPPORTUNITY FOR IMPROVEMENT

The opportunities to lower the fixed costs stem from the above mentioned cost-drivers: amount of equipment committed to the selling process and the space allocated to selling.

Equipment Sizing

Equipment is sized by expected throughput, i.e., sales volume, menu scope, and the concept design and intent—image and ambiance. Each of these elements should be considered prior to the operational design, and equipment plan and specifications. Equipment is a trailing decision, not a leading decision.

- Restaurant and foodservice operators plan equipment specifications based on the knowledge that restaurants will be redesigned/overhauled every 10–12 years. Therefore, equipment that will last 20–30 years is not necessarily a benefit.

Space Allocation

The issues that determine the amount of space required for the selling and merchandising area are the same as those involved with determining the equipment package—sales volume, menu scope, and concept design.

Other factors impacting space allocation that should be considered are the work flow and employee traffic patterns. More space is not necessarily a benefit; smart space is a benefit, i.e., a layout to create efficient operational work flow is a key efficiency determinant.

TOOL KIT

The tools to be used to improve the costs and, thus, the efficiency of the supermarket foodservice department at the store level include:

- preplanning—determine sales expectations, menu scope, and concept image before purchasing the first piece of equipment or allocating space; and
- work/service stations—in existing operations, review the layout to improve the work flow; determine how to better service the customer in the most efficient manner.

INTRODUCTION/DEFINITION

The front end management cost line is an allocation of the cost of operating the front end of the supermarket. The front end costs include:

- check-out space and equipment;
- labor associated with operating the check-out lines/stations;
- service center costs; and
- store management costs.

Costs related to front end operations are allocated back to the departments that are part of the supermarket, i.e., service bakery, produce department, meat department, dairy, grocery, and other departments.

FRONT END COSTS AND THIS STUDY

This study was not concerned with the front end operations nor the allocation process involved in distributing front end costs to the supermarket foodservice department.

Therefore, there are no observations, findings, or recommended improvements presented.

The front end costs were accepted as reported.

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INTRODUCTION/DEFINITION

The net profit at the store level is the result of the design and management of the supermarket foodservice operation. In this report, the net profit is for the store level before taxes and interest. Therefore, the net profit does not include:

- corporate management or supervisor management costs outside the department, other than those allocated through front end management costs; and
- other corporate allocations for inventory, interest, or other items.

CURRENT SITUATION

The supermarket foodservice scenario developed for this study is based on detailed operational and cost research conducted at store and chain headquarter levels. It reflects the sales volumes generated by the industry's foodservice departments. It also reflects the level of costs being realized in those departments.

Based on this study, the data suggest that a large number of supermarket foodservice operations are not generating a profit at the store level. It should be quickly pointed out that the study audited a number of foodservice operations that were generating a profit at the store level and even with the corporate burden factored into the P&L.

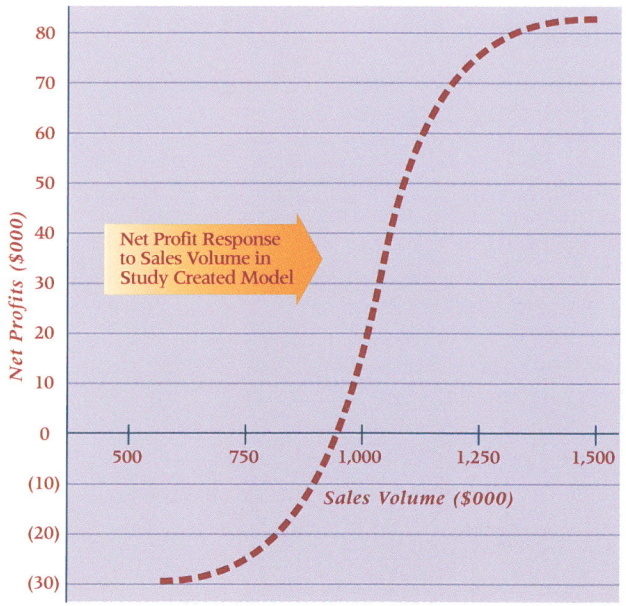
The profitable operations were in the minority and were operations that reflect a commitment at the senior most level to make the operation a lead department in the supermarket concept.

OPPORTUNITY FOR IMPROVEMENT

Supermarket foodservice can be a profitable operation. Net profits are driven by:

- driving the top line;
- constructing an efficient menu mix;
- managing costs;
- training the staff; and
- creating the right sized equipment and facilities.

Supermarket Foodservice Net Profit Response to Sales Volume



Driving the Top Line

The volume of sales generated by the operation is the beginning point in the quest to have a profitable operation. The primary drivers of sales volume include:

- provide a superior value proposition so the consumer has the desired outcome and chooses supermarket foodservice as a meal solution option on a regular basis;
- use features and advertising to communicate the consumer's value proposition and the brand value of the supermarket foodservice operation; and
- operate the supermarket foodservice concept as it is designed to be executed and do so consistently—everyday, all day—so consumers will learn to trust the concept as a consistent, credible, and safe provider of meal solutions.

Sales volume begins to address shrink issues, overhead, absorption issues, and sufficient staff to maintain a high service level. A high enough sales volume can also overcome unacceptable profitability.

Sales volume is one of the critical factors to success in a foodservice operation. It is difficult to operate any foodservice operation at low sales volumes, i.e., $1 million or less, unless food costs are extremely low; and/or miniaturized concepts, such as kiosks, carts, or facade type units are used.

Constructing an Efficient Menu Mix

A significant factor impacting the negative net profit realized in the supermarket foodservice operation is the ***shrink factor***. This can account for 12–15% of costs. It is a non-value-adding cost and should be managed to a lower level.

- Shrink will always be part of a foodservice operation; it will not completely go away.
- Shrink can be managed to an acceptable level; acceptable is estimated to be less than 5%.
- Shrink drivers should be identified—products or raw materials, recipes, preparation steps—and managed.

The first step in managing shrink is to plan the menu with consideration for the shrink factor.

- The concept should have a menu scope that is manageable; not too broad, or shrink will be a factor. An efficient menu assortment is planned within the context of the concept format.
- The menu should attempt to use versatile ingredients—multiple roles in multiple recipes/finished products. The goal is a limited number of raw materials that produce an efficient assortment.
- The menu should accommodate the ability to use perishable finished products reworked into other more highly stable finished products. For example:
  - *Boston Market's overproduced rotisserie chicken is used to make chicken pot pies.*
  - *Wendy's fresh hamburger that is not used on the day of preparation is used as an ingredient in chili.*
  - *Vegetables, meat, and chicken that are not used during a planned day find their way into soups, sauces, and/or casseroles.*

"Just like Mom—use the left-overs!"

The menu should not be a random assembly of finished products but should have a rationale—the concept—and be crafted with an eye to operation efficiencies.

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MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

Managing Costs

A foodservice concept can be executed successfully and consistently across multiple stores if it has a staff/management that has access to, and uses, a real-time measurement and management system at the store level.

The supermarket foodservice industry must put back-room management systems in place that have:

- set productivity standards for all aspects of the operation—food yield, labor productivity, and space productivity, as well as other drivers of cost;
- a forecasting and scheduling capability that allows management to anticipate sales volume and, thus, food preparation, food merchandising, and labor needs; and
- a tracking component that can track performance versus plan and the areas, or reasons, for deviation.

These systems are widely used in foodservice. They are now mostly computerized. These systems provide managers with a real-time picture of the business—top line to bottom line—so they can be proactive in managing the business.

Training the Staff

One of the major findings of the study was the lack of training of managers and employees operating the foodservice concepts. Staffing was drawn from all parts of the supermarket and training was, in most instances, non-existent. It would be difficult, if not impossible, to expect the foodservice department to be profitable or to meet consumers' expectations under these conditions.

Training is the executional backbone of a successful foodservice operation. Training provides:

- the overall concept—expected delivered value proposition to the consumer;
- knowledge of what is expected of the employee and why;
- the way to carry out the various "jobs" in the operation and tasks associated with that job/position;
- the skills and tools available to perform the tasks efficiently and correctly; and
- the way to work as a team and the benefits/rewards of being a team player.

Training must be a major, on-going function in a successful foodservice operation at the manager level and employee level.

Creating the Right Sized Equipment and Facilities

The final major category of cost to be managed in the context of the foodservice operation is the facility—the equipment, space, and ambiance. The focus should be to have what is needed; no more, no less. Therefore, the starting point is, of course, the concept design and planned value proposition/desired outcome for the consumer. These should be established and committed to before the first piece of equipment is purchased or space allocated.

Once the concept is established and commitment is gained:

- carefully plan the equipment requirement, and select equipment that is efficient and versatile in the concept planned;
- plan the amount and layout of space to assign to the working environment that is not hostile to employees and is efficient; and
- create work and serving stations that enhance efficiency.

The system is more important to successful operations than equipment, which is not linked into an operating system.

This report to this point has addressed the P&L for a supermarket foodservice department as it is understood and operationally implemented today. The scenario presented in this report suggests a large number of supermarket foodservice departments are losing money as they are operated today.

However, based on the understanding and insights into:

- **the supermarket foodservice operations uncovered in this study; and**
- **the operational practices of the foodservice industry provided by The Hale Group;**

it is believed there are ways to improve the performance of the business. This page and the following page address those areas of needed management focus to stimulate improved performance.

CURRENT SITUATION

The current situation in supermarket foodservice is not a crisis situation. The departments, in many instances, are losing money because they do not recognize and acknowledge this is the current situation. Once this is understood and acknowledged, the strategies, programs, and processes are there to improve performance—for shareholders, managers, and customers.

FUTURE OPPORTUNITIES

The supermarket industry can look to improved performance by implementing the foodservice enablers at the operating level. The enablers provide the "software" to make the "hardware," i.e., the concept, work. The enablers are:

- **standard specifications and procedures—consistency;**
- **supplier network and supply system;**
- **organizational design to focus and discipline the execution;**
- **training and motivation to provide the skills, direction, and tools; and**
- **forecasting and measurement systems to know how the business is performing.**

These enablers, as well as a review of menu mix and menu design, are the primary levers available to supermarket foodservice managers to improve the performance of existing operations, absent a major re-engineering of the strategies, concept, and operating model.

"POSSIBILITIES"
P&L FOR SUPERMARKET FOODSERVICE

	COSTS ($000)	PERCENT (%)
PRODUCTION COSTS		
FOOD/INGREDIENTS	$180.0	56%
LABOR	95.0	28
SHRINK	4.5	1
OTHER COSTS	23.0	7
FIXED COSTS	25.0	8
COST OF GOODS	$327.5	100%
SALES	$780.0	100%
COST OF GOODS	327.5	42
GROSS MARGIN	452.5	58
FEATURE COST	45.0	6
MARKDOWNS/SHRINK	23.0	3
GROSS PROFIT	$384.5	48%
LABOR	182.2	23
TRAINING	22.0	3
OTHER CONTROLLABLES	30.0	4
TOTAL CONTROLLABLES	$234.2	30%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	22.0	3
FRONT END MGMT.	35.1	4
TOTAL OTHER	$69.7	8%
NET PROFIT	$80.6	10%

SOURCE: THE HALE GROUP ESTIMATES

ANNUAL FINANCIAL PROFILE
OF SUPERMARKET FOODSERVICE
AT A STORE-LEVEL OPERATION

	COSTS ($000)	PERCENT (PERCENT)
PRODUCTION COSTS		
FOOD/INGREDIENTS	$196.1	55%
LABOR	99.6	28
SHRINK	7.5	2
OTHER COSTS	23.8	7
FIXED COSTS	28.7	8
COST OF GOODS	$355.7	100%
SALES	$780.0	100%
COST OF GOODS	355.7	46
GROSS MARGIN	424.3	54
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ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

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AT A STORE-LEVEL OPERATION

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SOURCE: THE HALE GROUP ESTIMATES

Menu Mix and Menu Management

Have an efficient assortment of products; select a sourcing strategy so there is shrink control due to how the products/raw materials are received/portioned, and how products that are not sold on Day One can be utilized safely in products for Day Two. This is a standard practice in the foodservice industry.

Training and Motivation

This is key in a value-adding delivery system, such as foodservice. The staff must understand what is expected of them and how these expectations fit into the concept execution. Management should find ways to provide rewards/recognition for a job well done. As mentioned previously in this report, The Hale Group projects a 5–8% positive impact on the supermarket P&L through on-going organized training.

Forecasting and Measurement Systems

Systems are an integral part of the efficient and effective operating model in foodservice. Forecasting demand leads to better utilization of raw materials; lower shrink; better scheduling of labor to meet tasks and demand; and fits with the organizational design. Measurement systems allow managers to identify the difference between anticipated performance (planned) and achieved performance. This focuses managers' attention and problem-solving skills on the areas that need attention and improvement.

Forecasting and measurement will provide an improvement lift of 3–5%.

These three areas—menu mix management, training and motivation, and forecasting and measurement systems—in management's tool box can create a much more energized P&L for supermarket foodservice as shown on the previous page.

NEXT STEPS

ANNUAL FINANCIAL PROFILE OF SUPERMARKET FOODSERVICE AT A STORE-LEVEL OPERATION

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SOURCE: THE HALE GROUP ESTIMATES

The study, *Building a Meal Solution Delivery System: Understanding Supply-side Costs and Strategies for Supermarket Foodservice*, provides an excellent opportunity to view the operating practices and cost implications of current supermarket foodservice departments.

The study has been able to capture the current situation and allow the industry to view its situation from a strategic, as well as operational, vantage point. Executive and operating management can then be in a position to craft, or re-energize, their existing strategies to meet performance expectations and results that are sufficient to attract resources—capital and human—to the supermarket foodservice business.

To attract resources, there must be a vision, a plan, and commitment. Most strategic planning or visionary processes involve three steps.

- **Where are we?—situation analysis**
- **Where do we want to be?—vision and objectives**
- **How do we get there?—strategies, tactics, and resource commitments**

Furthermore, the plan of action going forward has close-in initiatives, i.e., those that have an impact on the business short-term; and long-term initiatives, i.e., those that provide the basis for long-term success.

RECOMMENDATION—PLANNING PROCESS

Based on this study, The Hale Group recommends supermarket executives who have implemented a supermarket foodservice department undertake a strategic planning or visioning process that addresses the two stages of a foodservice implementation process.

Stage 1: Improving Existing Operations

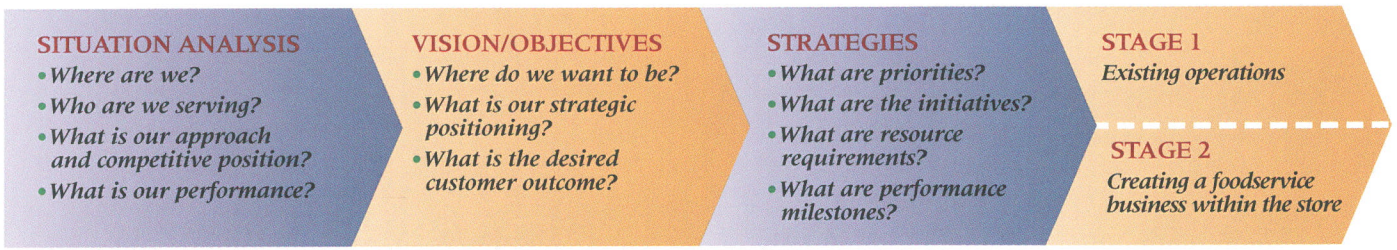
Stage 2: Creating a Foodservice Business (versus Department)

The planning process would flow as shown in the exhibit below.

There is an opportunity to improve the performance of the existing operations in terms of customer satisfaction and financial performance. Undertaking a planning or visionary process will be a major piece of the improvement process since it will cause management at multiple levels of the supermarket organizational structure to:

- **develop a commitment by supermarket executives to improve and the resources to do so; and**
- **create a foodservice business rather than a foodservice department.**

Supermarket Foodservice Planning/Visioning Process to Align Implementation



SUPERMARKET FOODSERVICE BUSINESS VERSUS DEPARTMENT

The supermarket industry has built its success on assembling an assortment of food and beverage products and offering those to the consumer in an attractive, clean, and user friendly environment at an acceptable or superior value. The organization of the store is in departments; each department management is responsible for assembly of an assortment of products that fit with the positioning of the store and the customer base it serves. Tools used to manage the grocery business are in place and suited to the grocery business. The competitive set of supermarkets, traditionally, look alike and operate alike.

The foodservice department has different needs, customer expectations, and competitive set. The foodservice department, when viewed as a department, is approached as any other department in the supermarket in terms of operational support, organizational design, and resource commitment.

Supermarket foodservice will require special treatment and handling to:

- **overcome organizational inertia to do more of the same; and**
- **gain attention to establish supermarket foodservice as a preferred supplier of freshly prepared meals for the U.S. consumer.**

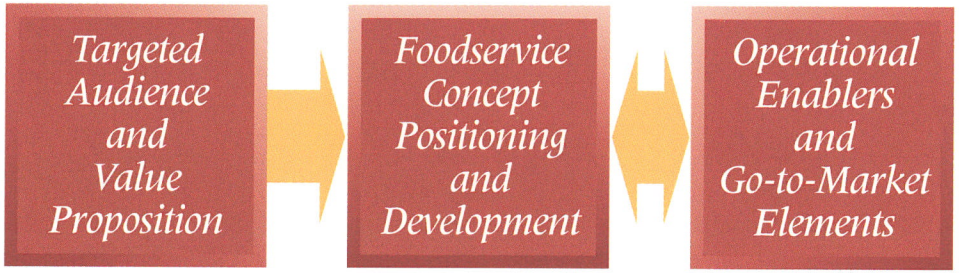
STRATEGIC VISIONING FOR SUPERMARKET FOODSERVICE

The planning process should address the elements of the foodservice business that were identified at the onset of this report and as shown below.

Supermarket executives need to identify the target audience; the value proposition to be provided; a unique foodservice concept fashioned to deliver the value proposition, as well as build brand equity in the supermarket's foodservice brand. Finally, the plan must assure that the foodservice enablers are in place so consistent execution is achieved.

The foodservice success model can be summarized by: **"System superiority is more important in the software era than product superiority—product superiority is the tablestake."**

Strategic Process for Building Supermarket Foodservice Business



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SOURCE: THE HALE GROUP ESTIMATES

APPENDICES

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A La Carte

This term describes meal solutions that are assembled by the consumer in "parts" or components with each item being priced separately. This is the type of pricing found in typical deli stations.

Batch (batching)

Combines recipes for a more efficient use of equipment, labor, food, and utilities. A recipe will be built up from the production of one menu item to the production of a number of items. Restaurants will typically make high volume menu items in batch sizes to more efficiently use labor and resources.

Break Even Analysis

This provides a graphical analysis of the required volume to cover fixed expenses for a foodservice establishment. A detailing of variable and fixed cost is provided and the volume required to derive profits is graphically displayed.

Controllable Expenses

Expenses that are the direct responsibility of management and can be influenced and controlled with proper focus and attention. Labor, food and beverage, supplies, and utilities are typically referred to as controllable foodservice expenses. A certain percentage or minimum number of each of these is considered to be fixed (what is required to open the doors for business).

Food Cost

Refers to the cost of goods sold (food and non-alcoholic beverages) within a foodservice establishment. Calculation of the *food cost percentage* is derived by dividing the actual cost of food and non-alcoholic beverages by the total sales for those food and beverage items. To calculate food cost for a specific menu item, simply divide the cost of that item by its sales. True Food Cost would take into consideration all food tied up in inventory (paid for, but not sold) as this is a liability to the operation. In terms of this study, food cost percentage does not include inventory, but inventory cost implications are detailed.

FIFO (First In, First Out)

This is a method of accounting for inventory as it is received. This method assumes that the first inventory received is the first inventory to be sold (First In, First Out). When dealing with perishable food items, this method is the most commonly used to prevent shrink from food loss or spoilage.

Quick Service (QSR) or Limited Service Restaurant (LSR)

Foodservice operations with counter service rather than table service. The consumer typically pays for the food prior to consumption. Typically alcohol is not served but there are some exceptions. The operations may or may not have a facility to eat on premise and may include a drive-through. Food in these operations is packaged to order and prepared/finished very close to the time of consumption. Average checks range from $2.00 to $7.00 and lunch and dinner are the primary focus, though many offer breakfast.

- **Examples of quick service restaurants include McDonald's, Burger King, and Blimpie's.**

Midscale/Family

Foodservice operations that offer table service and typically feature homestyle foods. Average checks range from $3.00 to $10.00, many family operations service all three dayparts. Family restaurants do not typically feature alcohol, though there are exceptions.

- **Examples of midscale/family restaurants are Cracker Barrel, Friendly's, and Denny's.**

Concept

A foodservice concept includes all the elements that create a position in the marketplace. These elements include menu, type of food, cooking style, price point, decor, theme, daypart focus, ambiance, staffing roles, service style.

Daypart

Daypart refers to the meal periods served in the foodservice operation. Each daypart may have a different menu, price point, service style, and cooking style.

Menu Mix/Menu Engineering

The mix of menu items sold during a specific daypart is referred to as the menu mix. A foodservice operation plans an overall expected food cost based on this mix. The menu consists of high and low cost items as well as high and low volume items. Determining the best mix for the operation involves a process know as menu engineering. Foodservice operators will look at the items and rank them by food cost, profit margin dollar, and popularity with customers. The items chosen are positioned and priced on the menu to "steer the customer" and thus achieve the desired mix.

Production Planning

The process of matching the time of production to the time of consumption to assure the customer fresh product. Foodservice operators make use of information, including historical hour by hour sales information and other immediate factors such as weather conditions, special events, and targeted promotions. This process is often accomplished with the use of software, especially in the Quick Service (QSR) segment. Manual re-adjustments can be made by the management on duty.

Prime Costs

Prime costs consist of food and beverage as well as labor costs. These are the two costs most dramatically impacting unit profitability.

Culinorm

Standards of weight and measurement as applied to smallwares used in a foodservice operation. Examples of culinorms include hotel pans, #20 scoops, and 4 oz. ladles. The names of these items are specific to a size and function and assure accurate measurement, cook times, portioning, and storage locale/apparatus.

Occasion

The term occasion is used to describe a customer's eating event. A particular customer may consume food at home, in the car, at a restaurant, at a supermarket, or at some other place serving food. The number of eating occasions is projected through customer diary research compiled by an organization called NPD/CREST; this research is widely used by the foodservice industry to look at customer eating patterns. The value in this research is in knowing what types of food customers are eating, where they are eating it, and at what time of the day.

Hour by Hour Management

Foodservice operators manage their business by the hour. Through the use of historical data, the manager can determine how the organization is performing against plan and adjust production (see Production Planning) and staffing to match revised projections. This task is typically accomplished with database software. The practice of hour by hour management is a major component of cost containment for a manager.

Turnover Rate

This rate depicts the number of employees leaving a foodservice establishment in a defined period of time. It is derived by dividing the number of employees terminated or separated over a set time period by the number of employees on staff at the midpoint of that time period. This number is then multiplied by 100 to determine the percentage turnover for the period. Foodservice turnover typically exceeds 100% due to the high percentage of transient workers employed.

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SOURCE: THE HALE GROUP ESTIMATES

Equipment	*Brand*	*Size/ Capacity*	*Price*	*Scratch Production*		*Prep/Assembly Only*		*Display Cooking/ Selling*	
				Number	Cost	Number	Cost	Number	Cost
COOKING									
Range	Vulcan	4 burner	$1,150	1	$1,150	1	$1,150		
Convection Oven	Blodgett	double	10,800	1	10,800	1	10,800		
Holding Cabinets	Alto-Shaam		1,500	2	3,000	1	1,500	1	$1,500
Microwave	Panasonic	1000 watt	800	1	800	1	800	1	800
Steam Kettle	Groen	40 gal.	6,000	1	6,000				
Steamer	Hobart	countertop	2,500	1	2,500	1	2,500		
Pressure Fryers	Henny Penny	single	5,500	1	5,500	1	5,500	1	5,500
Fryers	Pitco	double	1,200	2	2,400	2	2,400	2	2,400
Hood		18′	6,600	1	6,600	1	6,600	1	6,600
Fire Suppression	Kidde		2,800	1	2,800	1	2,800	1	2,800
DISPLAY COOKING									
Charbroiler	Vulcan		1,600	1	1,600			1	1,600
Rotisserie	Old Hickory	28 each	8,000	1	8,000	1	8,000	1	8,000
Deck Oven	Blodgett		4,200	1	4,200	1	4,200	1	4,200
Double Wok	Hubert	5″	3,800	1	3,800	1	3,800	1	3,800
Sandwich Unit	Delfield	6′	2,500					1	2,500
PREPARATION									
Blast Chiller	Hobart	5″	28,000	1	28,000				
Blender, hand-held	Hamil. Beach	single	230	1	230				
Food Processor	Robot Coupe	R4N	2,450	1	2,450				
Mixer	Hobart	30 qt.	5,200	1	5,200				
Hotel Pans[1]	Vollrath	asstd.	51	66	607	33	303	33	303
Work Table	Eagle	8′	1,850	1	1,850	1	1,850	1	1,850
Work Table	Eagle	5′	400	4	1,600	2	800	2	800
Slicer	Hobart		400	1	400				
Mixer	Hobart	5 qt.	250	1	250				

[1]Includes: stainless steel full, half, quarter, third, sixth, and ninth of varying depths

(continues)

Equipment	*Brand*	*Size/ Capacity*	*Price*	*Scratch Production*		*Prep/Assembly Only*		*Display Cooking/ Selling*	
				Number	Cost	Number	Cost	Number	Cost
STORAGE									
Shelving	Metro	2′×4′×4s	$400	10	$4,000	5	$2,000	5	$2,000
All-purpose Carts	Eagle		270	3	810	3	810	3	810
Rolling Racks	Eagle		125	6	750	6	750	6	750
Walk-in Cooler		15′ × 15′	11,250	1	11,250	1	11,250	1	11,250
Walk-in Freezer		10′ × 15′	11,250	1	11,250	1	11,250	1	11,250
DISPLAY									
Risers 1″, 2″, 3″	Hubert		18					12	216
Ceramic Platters	Hubert		13					36	450
Lexan Inserts[2]	Cambro	asstd.	25					54	228
Serving Utensils[3]	Vollrath	asstd.	52	40	332	20	166	104	480
Hot Case (service)		8′	14,000					1	14,000
Cold Case		52′	58,000					1	58,000
Hot Case (self-serve)	Anteco		10,500					1	10,500
Refrigeration (undercounter)	remote		4,000					1	4,000
Self-serve Refrigerated Case		28′	14,600					1	14,600
UTILITY									
Hand Sink	Eagle		165					1	165
Pot/Prep Sink	Eagle		1,380					1	1,380
Garbage Disposal	Hobart	1.5 hp	1,350	1	1,350				
Printing Scale	Toledo	8460	3,300					3	9,900
Subtotal					***$129,480***		***$79,230***		***$182,634***
Tax	5.0%				6,474		3,961		9,132
Inbound Freight	3.0%				3,884		2,377		5,479
Installation (union)	14.0%				18,127		11,092		25,569
Total					***$157,965***		***$96,660***		***$222,813***

[2]Includes: lexan steel full, half, quarter, third, sixth, and ninth of varying depths

[3]Includes: knives, colanders, spatulas, scrapers, ladles, spoons (slotted and solid)

ANNUAL FINANCIAL PROFILE OF SUPERMARKET FOODSERVICE AT A STORE-LEVEL OPERATION

	COSTS ($000)	PERCENT (PERCENT)
PRODUCTION COSTS		
FOOD/INGREDIENTS	$196.1	55%
LABOR	99.6	28
SHRINK	7.5	2
OTHER COSTS	23.8	7
FIXED COSTS	28.7	8
COST OF GOODS	$355.7	100%
SALES	$780.0	100%
COST OF GOODS	355.7	46
GROSS MARGIN	424.3	54
FEATURE COST	42.4	5
MARKDOWNS/SHRINK	84.9	11
GROSS PROFIT	$297.0	38%
LABOR	196.0	25
TRAINING	3.9	1
OTHER CONTROLLABLES	40.6	5
TOTAL CONTROLLABLES	$240.5	31%
ADVERTISING	3.9	1
MAINTENANCE	8.7	1
DEPRECIATION/RENT	27.8	4
FRONT END MGMT.	35.1	4
TOTAL OTHER	$75.5	10%
NET PROFIT	($19.0)	(2%)

SOURCE: THE HALE GROUP ESTIMATES

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OF SUPERMARKET FOODSERVICE
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SOURCE: THE HALE GROUP ESTIMATES

Preparation Category	*Menu Item*	*To Be Modeled* Popular	Premium
❑ Clear Soups	○ chicken noodle soup	✔	
❑ Cream Soups/Chowders	○ corn chowder		✔
❑ Starch	○ stuffing	✔	
❑ Sauce	○ mushroom gravy		✔
❑ Pasta with Sauce	○ macaroni and cheese	✔	
❑ Filling and Stew	○ chicken pot pie filling		✔
❑ Value-added Vegetable	○ mashed potatoes/ garlic mashed potatoes	✔	✔
❑ Roasted/Grilled Protein	○ rotisserie chicken/glazed, marinated rotisserie chicken	✔	✔
❑ Prepared Protein	○ meatloaf	✔	
❑ Layered Casserole	○ lasagna		✔
❑ Slow-cooked Side	○ baked beans		✔
❑ Salads	○ potato salad	✔	
❑ Pizza	○ four cheese pizza		✔
❑ Sandwich	○ smoked turkey sandwich		✔

THE COCA-COLA RETAILING RESEARCH COUNCIL

PURPOSE

The purpose of the Coca-Cola Retailing Research Council is to identify major research needs in the food distribution business and conduct studies designed to bring wholesalers and retailers, both large and small, practical guidance on how to address these issues. The Council has operated since 1978 and in that time has produced 15 major reports, including this study, on a broad range of topics.

Alan McClay
Vice President,
Business Development
Comite International des
Enterprises a Succursales (CIES)
Paris, FRANCE

Herb Young
Former Group Vice President,
Sales & Marketing
Dominick's Finer Foods
Northlake, IL

Tim Hammonds
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Food Marketing Institute (FMI)
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Carole Bitter
President, CEO, CFO
Friedman's Supermarkets
Butler, PA

Charles Genuardi
President, CEO
Genuardi Supermarkets, Inc.
Norristown, PA

Ned Dunn
Former President
Harris Teeter, Inc.
Matthews, NC

Fred Ball
President
Hen House Markets
Kansas City, KS

Dan Kourkoumelis
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Hughes Family Markets
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Neil Golub
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East Bridgewater, MA

James B. Meyer
President, CEO
Spartan Stores, Inc.
Grand Rapids, MI

Terry Peets
Former Executive
Vice President
The Vons Companies, Inc.
Arcadia, CA

Building a Meal Solution Delivery System: Understanding Supply-side Costs and Strategies for Supermarket Foodservice 1998
The Hale Group, Ltd.

Where to Look for Incremental Sales Gains: The Retail Problem of Out-of-Stock Merchandise ...1996
Andersen Consulting

Measured Marketing: A Tool to Shape Food Store Strategy 1993
Brian P. Woolf, Retail Strategy Center, Inc.

New Ways to Take Costs Out of the Retail Food Pipeline 1992
Mercer Management Consulting

Strengthening Your Relationships with Store Employees 1991
Robert M. Tomasko, Washington, DC–based consultant to Arthur D. Little, Inc.

Supermarket Merchandising for the 1990s 1989
Booz, Allen & Hamilton

Assessing and Capturing the Soft Benefits of Scanning 1988
Professor Robert Blattburg, Graduate School of Business, University of Chicago

Improving Store Manager Effectiveness 1986
Human Synergistics, Inc.

Managing the Large Food Store of the Future 1984
Arthur D. Little Co.

Lessons from Japan 1983
Michael O'Connor

Planning Your Financial Growth in the 1980s: A Financial Planning Model for Food Retailers 1982
Robert D. Buzzell, William E. Fruhan, Walter Salmon

Product Improvement Techniques & Strategy for the Supermarket Industry 1981
Professor Bobby Calder, Graduate School of Management, Northwestern University

The Impact of Energy on Food Distribution in the 1980s 1980
John Morrissey, Senior Vice President, Super Valu Stores, Inc.

An Economic Analysis of the Distribution Industry in the United States 1980
Arthur Andersen & Company

Social Trends and Food Retailing 1980
SRI-International

EXECUTIVE SUMMARY

The Coca-Cola Retailing Research Council (CCRRC) is a grocery industry service group established and funded by The Coca-Cola Company through its divisions Coca-Cola USA and The Minute Maid Company. The CCRRC consists of twelve (12) members who are senior executives of their respective organizations. The purpose of the Council is to research strategic issues of industry-wide interest and disseminate information to industry participants so they are in a position to address these issues effectively.

This year the CCRRC selected Supermarket Foodservice as the strategic issue to be addressed—specifically, the development of foodservice departments and their profitable operation. Thus, the CCRRC initiated this study to ***understand supply-side costs and strategies for supermarket foodservice***.

The objectives of the study were to understand the costs associated with delivering "restaurant-quality" meals in a supermarket setting and to identify ways to manage those cost elements to improve overall performance.

APPROACH

Based on extensive in-market and in-store research and data gathering, The Hale Group, Ltd., the consulting firm retained to complete the study, was able to understand:

- the current operational models supermarkets use today to provide "restaurant-quality" meal solutions; and
- the "possibilities" to improve the performance of existing supermarket foodservice operations, as well as create foodservice operations from the ground up that have a better strategic fit with the supermarket's overall market positioning.

The following findings and conclusions have been developed through an analysis of this information.

FINDINGS AND CONCLUSIONS

1. The underlying business philosophy of foodservice operations is markedly different from the business philosophy of grocery retailing.

   ○ *Traditional grocery retailing involves purchasing and reselling products, in essentially the same form, for a profit; the better the* buy, *the larger the profit.*

   ○ *In foodservice, profit is developed to a limited degree on the buy, and to a far greater extent on the development of value at the retail level, assembling ingredients, adding labor and creativity, merchandising and selling at an acceptable price; the greater the customer-perceived* added value, *the greater the profit.*

Formulating a Supermarket Foodservice Strategy

CUSTOMERS

Who is the target audience?
Who are the core customers?
Who will sustain the business?

VALUE PROPOSITION

What is the value proposition that will
- be of value to targeted customers?
- provide a basis for differentiation?
- generate value for both customers and investors?

GOING-TO-MARKET

How will the value proposition be generated in the store?
How will it be managed?
How will the value proposition be branded?
How will the brand be communicated to targeted customers?

The recommendation is to view foodservice as a business within the supermarket store, not a department that is operated similarly to all other departments.

2. Having a foodservice offering within the supermarket is widely accepted by supermarket management. However, most supermarkets have yet to develop a foodservice strategy that flows from their overall strategy.

The recommendation is for supermarket management to take a strategic view prior to committing resources.

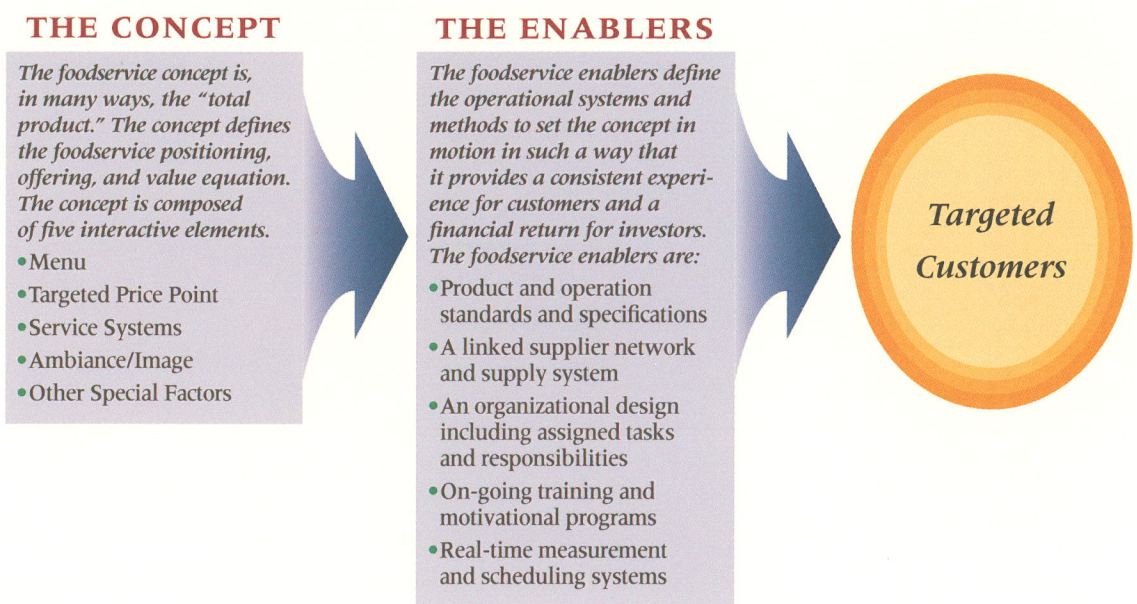
Once a decision has been reached to develop a foodservice strategy, resource commitments will be key. Unless supermarket management is willing to make a commitment to resources—capital and human—and institute new ways of doing business, success will be difficult to realize.

3. The Going-to-Market or execution of the foodservice strategy involves two major building blocks—The Concept and The Enablers; few supermarket managements today have these basic operational pieces in place.

It is recommended that supermarket management clearly define ***the concept*** that will deliver the value proposition/desired customer outcome and put into place the operational system—***the enablers*** necessary to generate consistent execution of the concept. It will be difficult, if not impossible, to succeed without a defined concept and operational tools—the enablers needed to execute the concept in a consistent and profitable manner.

4. The supermarket industry has not fully understood the cost of sourcing options available nor the implications of the various options in terms of consistency, ease of implementation, and customer satisfaction. While, at first glance, the "cost of goods" shown in the following chart seems counter-intuitive, the study, as well as the experience of the foodservice industry, as understood by The Hale Group, supports the findings.

Execution of the Foodservice Strategy



FOR A SUPERMARKET FOODSERVICE OPERATION WITH ANNUAL SALES OF $780,000 THE SOURCING MODEL AND COST OF PRODUCTION

Sourcing Options	*Cost of Goods* ($000)	*As a Percent of Sales* (percent)	*Considerations/ Characteristics*
On-site/Scratch Preparation	$355.7	46.0%	*Requires trained/skilled labor; can be beneficial for selected signature menu items; however, cost savings seldom realized due to requirement for higher handling cost in the selling phase*
From a Manufacturer	377.7	48.0	*Higher costs, but requires lower on-site labor input, less space, and greater flexibility; signature products are difficult to produce unless very high volume*
From Commissary Operations	397.7	51.0	*Allows for greater control and signature items, but double handling adds costs… costs combined with lower than necessary volume can make this the highest cost alternative*

- *On-site/scratch preparation generates the lowest cost of goods; however, this method of production is difficult to implement because it requires skilled labor and it is difficult to achieve consistency of product quality.*
- *Manufactured products are the most consistent and benefit from the economies of scale/efficiencies of the manufacturing environment. However, there is another profit margin in this system along with greater distribution costs, which result in a higher cost of goods than on-site preparation.*
- *Commissary operations are frequently considered the optimum solution in terms of moving production labor from on-site preparation. However, commissaries seldom achieve the throughput required to have efficient production; and the multiple handling of the product adds another layer of costs. Commissaries do provide a higher degree of control and consistency, which are benefits to the system.*

ESTIMATED P&LS FOR A SUPERMARKET OPERATOR GENERATING $780,000 PER YEAR OR 3% OF STORE SALES

	Financial Profile of Supermarket Foodservice at a Store Level Operation		*"Possible" P&L for Supermarket Foodservice*	
	($000)	(percent)	($000)	(percent)
Production Costs				
Food/Ingredients	$196.1	55%	$180.0	56%
Labor	99.6	28	95.0	28
Shrink	7.5	2	4.5	1
Other Costs	23.8	7	23.0	7
Fixed Costs	28.7	8	25.0	8
Cost of Goods	$355.7	100%	$327.5	100%
Selling P&L				
Sales	$780.0	100%	$780.0	100%
Cost of Goods	355.7	46	327.5	42
Gross Margin	$424.3	54%	$452.5	58%
Feature Cost	42.4	5	45.0	6
Markdowns/Shrink	84.9	11	23.0	3
Gross Profit	$297.0	38%	$384.5	48%
Labor	196.0	25	182.2	23
Training	3.9	1	22.0	3
Other Controllables	40.6	5	30.0	4
Total Controllables	$240.5	31%	$234.2	30%
Advertising	3.9	1	3.9	1
Maintenance	8.7	1	8.7	1
Depreciation/Rent	27.8	4	22.0	3
Front End Management	35.1	4	35.1	4
Total Other	$75.5	10%	$69.7	8%
Net Profit	($19.0)	(2%)	$80.6	10%

Cost of goods sold, or the product cost, is only one consideration. Examples of other factors that must be part of the evaluation include:

- *anticipated sales volume—total department and for specific menu item;*
- *role of foodservice within the supermarket strategy and degree of culinary image to be created; and*
- *availability and skill level of the labor pool.*

It is recommended that supermarket managers involved with foodservice concept development tailor their sourcing to match the strategy and concept. The sourcing options are a means to an end, not the drivers of decisions. Furthermore, it is unlikely that one sourcing option will be right for every menu item.

5. **The current profitability of supermarket foodservice operations is below what is achievable. An absence of clear concepts and of foodservice enablers are the main shortcomings. The P&L constructed for a typical supermarket foodservice operation, as well as one that describes what is "possible without revamping entire operations," is shown at left.**

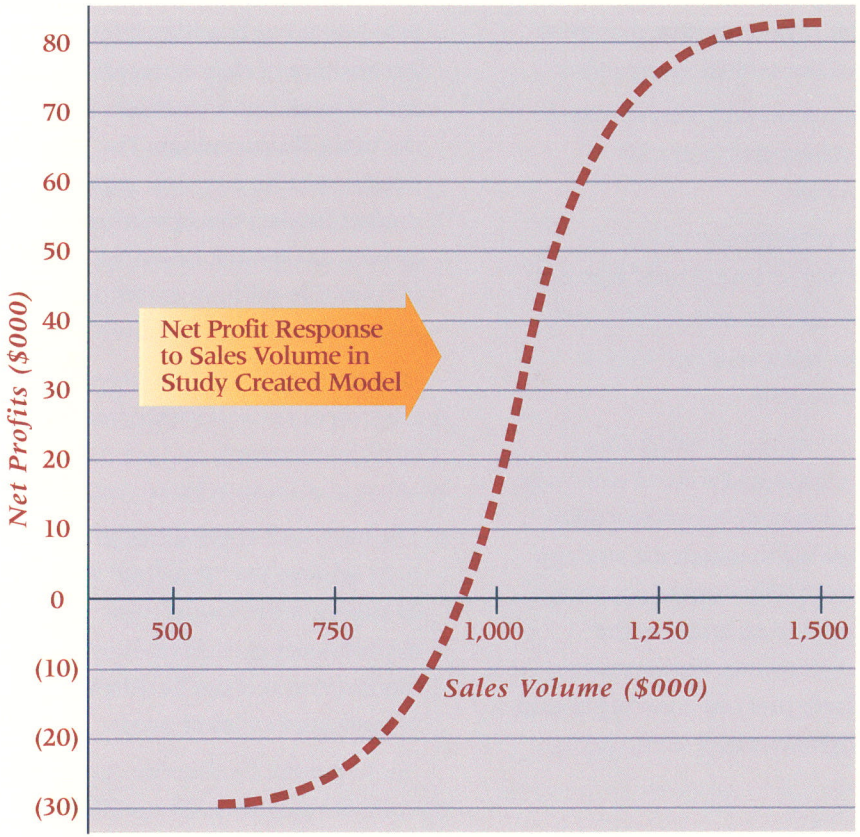
It is recommended that supermarket management reassess their operations using this framework and put the enablers in place to achieve profitability.

6. **The tools and approaches to help achieve the "Possible" P&L in supermarket foodservice departments exist in traditional foodservice and can be adapted to meet supermarket needs.**

Supermarket foodservice can be a profitable operation. Net profits are driven by:

- *driving the top line;*
- *constructing an efficient menu mix;*
- *managing costs;*
- *training the staff; and*
- *creating the right sized equipment and facilities.*

Supermarket Foodservice Net Profit Response to Sales Volume



Driving the Top Line

The volume of sales generated by the operation is the beginning point in the quest for a profitable operation. The drivers of sales volume involve:

- *superior value proposition so the consumer has the desired outcome and chooses supermarket foodservice as a meal solution option on a regular basis;*
- *using features and advertising to communicate the consumer's value proposition and the brand value of the supermarket foodservice operation; and*
- *operating the supermarket foodservice concept as it is designed to be executed and do so consistently—everyday, all day—so consumers will learn to trust the concept as a consistent, credible, and safe provider of meal solutions.*

Sales volume begins to address shrink issues, overhead absorption issues, and sufficient staffing to maintain a high service level. Sales volume can play a major role in achieving acceptable profitability.

Sales volume is one of the critical factors to success in a foodservice operation. It is difficult to operate any foodservice operation at low sales volumes, i.e., $1 million or less unless food costs are extremely low; and/or miniaturized concepts, such as kiosks, carts, or facade type units are used.

Constructing an Efficient Menu Mix

A significant factor impacting the negative net profit realized in the supermarket foodservice operation is the ***shrink factor***. This can account for 12–15% of costs. It is a non-value-adding cost and should be managed to a lower level.

- *Shrink will always be part of a foodservice operation; it will not completely go away.*
- *Shrink can be managed to an acceptable level; acceptable is estimated to be less than 5%.*
- *Shrink drivers should be identified—products or raw materials, recipes, preparation steps—and managed.*

The first step in managing shrink is to plan the menu with consideration for the shrink factor.

- *The concept should have a menu scope that is manageable—not too broad, or shrink will be a factor. An efficient menu assortment is planned within the context of the concept format.*
- *The menu should attempt to use versatile ingredients—multiple roles in multiple recipes/finished products. The goal is a limited number of raw materials that produce an efficient assortment.*

- *The menu should accommodate the ability to use perishable finished products reworked into other more highly stable finished products. For example:*

  - Boston Market's overproduced rotisserie chicken is used to make chicken pot pies.
  - Wendy's fresh hamburger that is not used on the day of preparation is used as an ingredient in chili.
  - Vegetables, meat, and chicken that are not used during a planned day find their way into soups, sauces, and/or casseroles.

"Just like Mom—use the left-overs!" The menu should not be a random assembly of finished products but should have a rationale—the concept—and be crafted with an eye to operation efficiencies.

Managing Costs

A foodservice concept can be executed successfully and consistently across multiple stores if it has a staff/management that has access to, and uses, a real-time measurement and management system at the store level.

The supermarket foodservice industry must put back-room management systems in place that have:

- *set productivity standards for all aspects of the operation—food yield, labor productivity, and space productivity, as well as other drivers of cost;*
- *a forecasting and scheduling capability that allows management to anticipate sales volume and, thus, food preparation, food merchandising, and labor needs; and*
- *a tracking component that can track performance versus plan and the areas, or reasons, for deviation.*

These systems are widely used in foodservice. They are now mostly computerized. These systems provide the manager with a real-time picture of the business—top line to bottom line—so they can be proactive in managing the business.

Training the Staff

One of the major findings of the study was the lack of training of managers and employees operating the foodservice concepts. Staffing was drawn from all parts of the supermarket and training was, in most instances, non-existent. It would be difficult, if not impossible, to expect the foodservice department to be profitable or to meet consumers' expectations under these conditions.

Training is the executional backbone of a successful foodservice operation. Training provides:

- *the overall concept—expected delivered value proposition to the consumer;*
- *knowledge of what is expected of the employee and why;*
- *the way to carry out the various "jobs" in the operation and tasks associated with that job/position;*
- *the skills and tools available to perform the tasks efficiently and correctly; and*
- *the way to work as a team and the benefits/rewards of being a team player.*

Training must be a major, on-going function in a successful foodservice operation at the manager level and employee level.

Creating the Right Sized Equipment and Facilities

The final major category of cost to be managed in the context of the foodservice operation is the investment—the equipment, space, and ambiance. The focus should be to have what is needed; no more, no less. Therefore, the starting point is, of course, the concept design and planned value proposition/desired outcome for the consumer. These should be established and committed before the first piece of equipment is purchased or space allocated.

Once the concept is established and commitment is gained:

- *carefully plan the equipment requirement, and select equipment that is efficient and versatile in the concept planned;*
- *plan the amount and layout of space to assign to the working environment that is not hostile to employees and is efficient; and*
- *create work and serving stations that enhance efficiency.*

The system is more important to successful operations than equipment which is not linked into an operating system.

7. The successful, i.e., robust and profitable, supermarket foodservice operations observed in the course of the study were the result of:
   - long-term management commitment—*not a one-year program;*
   - a clearly defined role of foodservice—*a foodservice concept designed specifically to fit the supermarket chain; and*
   - the right tools to manage the business—*unlike the tools used by grocery departments.*

Keys to success are vision, commitment, and prudently applied patience. Supermarket foodservice is a new business for most supermarkets. Organizational learnings and experience must be built; and while the development cycle can be shortened, it cannot be eliminated.

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