Cooperative Grocer
FOR RETAILERS AND COOPERATORS
From #118, May-June 2005

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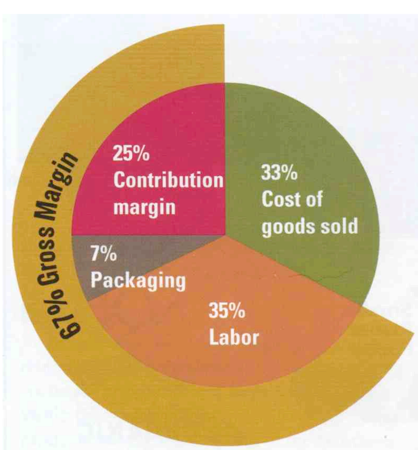
A Smoother Road to Foodservice Margins

Delis with a labor problem aren't hard to come by. Newer teams guzzle labor dollars while struggling to achieve a learning curve and a critical mass of cooperation. Until your foodservice department is large enough to mask some inefficiencies and blunders in your pricing and menu mix, every hour of labor is a precious investment. Add in time for administrative and development projects, and many a modest-sized deli toils to meet even a generous labor budget of 35 percent.

But a deli with a margin problem? The executive chef at a large co-op recently told me her deli "hasn't made a profit in five years." During the financial segment of a recent foodservice seminar, another co-op deli leader revealed she was learning proper margin pricing for the very first time. We run the least commoditized store departments, with the only teams that can fully develop and market homemade products. Our hefty labor budgets require the funding of the higher margins we're capable of earning from fresh-made products. If you're tired of driving on a bumpy road of poor or inconsistent margins, here are some key ideas for using budgeting, systems, pricing, and menu planning to build a smoother highway of improved margins.

Realistic margin goals

Let's be sure we're starting out with the same rules of the road by stating the textbook retail calculation for gross margin as "sales minus cost of goods." When



we're talking about a specific foodservice product, we sometimes use slightly different terms, alternatively saying that gross margin is "the retail price minus the food costs." Both of these calculate the gross margin, or the revenue from sales before deducting labor, supplies and overhead expenses. From the gross margin many stores also deduct the department's labor (excluding benefits) and call the result "margin minus labor." Additionally, some departments deduct the cost of department-specific supplies, terming what's left the department's "contribution margin."

Foodservice departments typically aim for an expense pie that budgets one-third of sales for cost of goods, another one-third for labor, and a sliver of the pie (about 7%) for napkins, utensils and other disposable supplies. Starting with sales of 100% and deducting 33% for cost of goods, 33% for labor and 7% for supplies yields a 26% contribution margin – just one point higher than the 25 point "margin minus labor" target many co-op delis strive for.

When you strip out the lower margin impact of the sub-departments and programs whose sales aren't from homemade product, a typical foodservice department margin goal is 67% – equivalent to food costs times 3. But pricing to achieve a 67% margin requires calculating in the product that won't ultimately be sold. Factor in 5 percentage points for waste and sampling, and you're talking about applying a pricing margin of 72 percent. The formula to price at a 72% gross margin is "food costs ÷ (1.00 minus 0.72)."

To simplify the math of pricing many delis simply apply a formula of "food costs multiplied by 4," which yields a 75 percent margin – a 3 point cushion after the 5 points priced in for waste and sampling. While a more precise margin-minded formula is recommended, using "food costs times 4" is a basic and reasonable strategy for ensuring your prices yield the margins needed to cover food and labor costs. Note that while the difference in pricing with a formula of "food costs times 3" and "food costs times 4" may sound large, it represents only an 8 point margin increase.

Steer clear of the costing pothole

The most common pothole on the road to proper foodservice pricing is recipe costing. Costing is especially challenging for grocery store delis because it calls for systems unlike those used by any other department. After all, the grocery and other departments get their product prices adjusted rather efficiently with a few POS system keystrokes. In foodservice, leaders and cooks need to specifically document a recipe, compute the value of each ingredient, total those costs, and divide that total by the recipe's finished weight or batch size. This is definitely more work, but you only have to do it when you invent a new product and every couple of seasons thereafter.

To get your costing and pricing systems in order, have a list of all your ingredient costs, a stack of cost-out forms and a calculator in the kitchen – right where your cooks produce new products. (Your inventory form or order book pages can probably be configured to become your list of ingredient costs.) Set a firm policy that no new products will be marketed from your kitchen without a proper recipe cost-out form and a service case sign or packaged scale label. Reserve for emergencies a strategy of using an "introductory price" on any item for which staff absolutely must guess – giving you some wiggle room if the next day's cost-out proves the intro price very inaccurate.

Delis that don't cost out their recipes and guess at pricing are notorious for under-pricing. Without a ready and usable costing system, pricing is left to the whim or judgment of whoever's handy. But entry-level staff members typically lack the context for judging what our customers will pay for the quality and convenience of homemade foods. Even experienced foodservice workers are capable of undervaluing the creativity, labor and food costs that need to be covered from full margin pricing. In pricing, there is a place for judgment, experience and instinct – but it comes in the form of tweaking a price after calculating the proper full-margin price, not before.

With ingredient costs at the ready and an hour of training most staff can learn to complete a recipe cost-out in just 15 minutes. To quickly get your department's costing duties behind you, host a mandatory "costing party." Gather a gaggle of your key full-time staff and teach everyone the proper way to complete a recipe cost out form, using your department's ingredient cost list. (You can download these forms and related documents on the "downloads" page of the DeliBlog at: http://www.clix.to/deliblog.) Practice costing out some recipes together. Then set the gang loose to complete a dozen each on their own. Your party could complete all the recipes in your current repertoire, and you will have educated enough people to ensure that every shift has at least one person who knows how to properly cost out a new recipe.

In the process of growing your team's financial education, look to see who emerges as a good candidate to take on some responsibility for reducing ingredient costs through improved purchasing. "We changed one of our suppliers and shaved about 15% off the top of a $1000 per week bill," said the kitchen manager of a large co-op in the Northwest. The all-too-busy department leader isn't always the person best suited to keep up with this responsibility, even if it's technically a part of their job description. In the end, it doesn't matter which person on your staff finds the vendors or local producers to bring you better deals; you just need to invest some modest chunks of time regularly to knock down costs where you can. With a sizable share of your department more focused on the cost of ingredients, your team may start to do a better job of getting and using whatever free product is available from produce, meat and other departments.

After costing your current menu, you may find some price increases or serving size adjustments are in order. If much of your menu needs to go up by as much as 20 percent, doing it all at once is probably the best route. After all, taking a $4.99 per pound salad up to $5.99 adds only 33 cents to a one-third pound purchase. If some of your items have been so under-priced as to require a whopping hike, you have the choice of stepping up the price incrementally, or doing it all at once. More often than not I recommend bringing your prices into line and getting it over with. "It's amazing," said the Northwest co-op kitchen manager. After correcting the price of their chicken breast entrees from $9 a pound to $12 a pound, staff haven't reported any flack from customers, and "I've not had one negative comment card."

If you must enact significant price increases across the board, nothing is more important than preparing your staff for the conversations they may have with customers. Role-play and provide them with enough information for them to respond intelligently and professionally. Choose to believe that your customers can appreciate that your department has made some mistakes in the past and is taking the fair measures necessary to operate profitably enough to continue serving them.

Beyond straight margin formulas are myriad variable pricing strategies aimed at maximizing total margin dollars. After all, financial performance can't all be about margin percentages when it's the margin dollars that pay the bills. If greater margin dollars can be achieved by lowering the price on some easy-to-make or commoditized items, you should consider taking that lower margin percentage. But you'll want to make it up by raising the margin on your more creative and hardest-to-produce items, especially on items for which you have no competition.

As an example: Say you sell a line of quickly produced cream cheese schmears, at the rate of 50 pounds per week for $7.99/lb., generating a 75% gross margin or $300. Let's say you're also selling a line of beautifully presented fish entrees at the rate of 105 pounds per week for an average of $12.99 per pound, which is generating a 60% gross margin or $818. Also assume the schmears each take one-third the labor time that the fish entrees take, and that only your most experienced, highest paid staff work on the entrees. With a variable margin pricing strategy, you might try to achieve higher total margin dollars by lowering the price of your easy-to-make schmears and raising the price of your competition-free, labor-intensive entrees.

With systems in place for analyzing such changes as you inaugurate them, you might very well find that at a lower 69% margin, or $6.49/lb., you can sell 75 pounds of schmears a week, generating $336 – a 12% increase in margin dollars. With the fish entrees at a higher margin of 67% and an average price of $15.75/lb, sales volume might drop by 15% to 90 pounds per week. But you would still earn $950/week – or 14% more margin dollars.

Sound like a fun way to increase sales and margin dollars? It is. But you can't apply, analyze, and tweak variable margin pricing decisions if you don't genuinely know your recipe costs and have a method for analyzing sales, production, waste, and margin. Without it, you won't be able to properly judge the impact of the measures taken to improve your margins. Did adding those two new products last week generate more margin dollars than the three items you discontinued? Are you running short and losing potential sales on any top sellers? Could you reduce some existing labor by making a few items less frequently and in larger batches?

You probably will keep some of the items that earn you a sub-standard margin, but with proper cost analysis you will have identified those products and know why they're worth keeping in your repertoire. The cost of an organic whole fryer, for example, doesn't make it easy to price rotisserie chickens much above a 50% gross margin. Knowing that a chicken program can unlock the potential for dinnertime sales of other foods, many delis are happy to put the requisite labor into them.

The paved road of consistent margins

With a foundation of essential deli systems in place for evaluating the performance of each menu item, you'll feel less like a passenger and more like the driver of your deli's financial destiny. The difference between guessing at prices and using functional systems for recipe costing and pricing is like the difference between a bumpy gravel road and a freshly paved one. By costing things out accurately before you sell your first batch and applying variable pricing strategies to maximize sales, you'll be on the highway to financial success in foodservice.

SIDEBAR STORY:

Petition the Kitchen Software Industry!

Nothing would so significantly assist the costing and pricing responsibilities of foodservice departments as a decent kitchen software program. Ever since Sierra Home stopped producing their top-selling MasterCook program, there has been a gap in the market for an affordable, easy-to-use program that accomplishes a critical triad of functions: recipe organizing, costing and nutritional analysis.

I've experimented with demo and full versions of many programs, from inexpensive shareware programs that simply organize your recipes, to professional programs that cost hundreds of dollars and are unduly cumbersome. Many of the professional programs lack a nutritional analysis function and, focused on cost and inventory control, require more data entry and provide more data than is needed by a typical natural foods grocery deli. Of the less expensive programs, none does recipe costing, and while many claim to perform nutritional analysis, most do it poorly.

Nothing comes closer to fulfilling the triad of critical functions better than does MasterCook. Because it has so many users (a Google search for "MasterCook" yields more than a million hits), there is a plethora of websites from which to download recipes in MasterCook's proprietary format. Although the program is no longer produced or supported, a number of online retailers still sell versions for next to nothing. (Be sure to choose the "deluxe" version that's right for your system, Macintosh or Windows, as some versions do not come with the full compliment of functionalities.) But many versions of the software don't work with the latest version of Windows XP, and Macintosh users can only open the program in OS 9.

Currently on the DeliBlog of Organic & Natural Foods at www.clix.to/deliblog you can read more about the pros and cons of recipe software programs, share your experiences and vote for the software features you most value. Through June 30 you can also sign an online petition to the creators of existing software programs, telling them what you're looking to buy in a new software program.

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