MONTHLY BRIEFING REPORT

March 2022

Published 1 April 2022

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Introduction

In addition to my Weekly Briefing Report, which remains free of charge, I provide a premium version which includes a subscription to my Quarterly Briefing Report and Monthly Briefing Reports. You can find details here.

I would value your feedback on topics you would particularly like me to add to my coverage – you can contact me at peter@peterbackmanfs.com or 07785 242809.

Introduction

Normally in my Monthly Briefing Report I try to do just that – report on the past month. But March this year has been a tumultuous 31 days – the war in Ukraine has unleashed a rise in inflation (on top of the inflation that was already in the pipeline) especially for food (grain, sunflower oil, some fruits and more) and energy. And there has been the Spring Statement which, amongst other things, did not stop the planned imminent rise in restaurant VAT which many had hoped for. Meanwhile the long term fall out from covid is still rumbling its way through society and the economy.

It has been difficult to pick out the threads of these, and the many, perhaps more mundane issues that affect the foodservice sector. So this month, I will take a look at a much-mentioned phenomenon that may have an impact on the restaurant sector over the coming year or two.

Following the herd?

Perhaps the top economic issue being talked about today is the pressure on living costs and peoples' ability to pay for what they used to consider essential – in short, the pressure on disposable incomes. This week, the ONS reported that 81% of adults reported a rise in their living costs, compared with 61% just before Christmas.

So, I want to talk about this means in terms of the 'squeezed middle'.

The notion of the 'squeezed middle' crops up in many places so I must confess that when I hear people observing the same thing, I ask myself "Are these just example of groupthink?". So, likewise, are the conclusions that I will finish with at the end of this piece, similarly just an example of groupthink? I don't think so, because my conclusions, like the issues involved are complicated and multifarious. So please bear with men

The term 'squeezed middle' was originally, and specifically, applied to those people on middle incomes who, according to the OECD, "feel left behind and have questioned the benefits of economic globalisation." The OECD definition goes on to detail some further specifics, but this extract captures the essence.

Over time, the term has come to be associated with a wider concept: that of any economic entity where those at the lower end and those at higher end benefit from market conditions, while those that are neither at the lower or higher end, suffer financially.

Do those conditions apply to the restaurant market today?

Let's see if we can find out.

The lower end

By the 'lower end' I mean the cheaper end of the market where customers are not charged so much. And in doing so, I am not talking about quality – you can have a good quality offer at the 'lower end' of the market (just as you can have a poor quality offer at the 'higher end').

What's happening to this part of the market right now?

There has been a notable rash of recent announcements by fast food operators regarding expansion plans in the UK: Starbucks plan to open 140 units in 2022; Wendy's plan 10 this year (down from, a probably inflatedly unrealistic, earlier plan for 50) as well as 40 or 50 dark kitchens operated from Reef sites; Burger King have announced plans to open 30 sites a year over a five year period.

Now while announcements of opening plans may be scuppered by events, the short term nature of these – and other - plans suggests that they are already in the process of being put into practice. So (some) owners of mainstream fast food operations – and in the cases I have mentioned, offers at the 'lower' end – must be seeing reasons for growth.

However, outlet expansion is no use without customers. But who will they be? Figures from the Office for Budget Responsibility say that 1 million people will be thrust into poverty (according to its definition) with the onset of the coming round of falling disposable income. And other people, who are currently reasonably well off, will become much poorer. All of these people and households will, of necessity, be forced to re-examine their spending priorities. And one of these priorities will, inevitably, include eating out. In other words they – those with the lowest incomes - will almost certainly be spending less in restaurants.

Now people like these, because they previously had modest disposable income will have frequented lower end places. If their spending is curtailed, the money they would have spent in restaurants will fall – leaving less money for the restaurants themselves.

This argues for the lower end of the restaurant sector becoming squeezed.

Higher end

Let's take a look at the more expansive end of the restaurant sector; I am not talking about the rarefied end of the most expensive restaurants, but places where you could reasonably expect to spend between, say, £30 and £50 a head.

As the pressure on incomes bites, what happens to the people who form the core market for these restaurants? I guess (I don't have real evidence) that they will be a little bit more careful on what they spend – but their day to day necessities won't really be affected. And, in these terms, day to day necessities would include going to a restaurant regularly – not that doing so is a ‘necessity’ but it is an ‘integral’ part of some (many?) people’s lives.

So, this higher end of the restaurant sector, should, if my analysis is correct, be relatively insulated from a reduction in disposable income.

In the middle

So, we come to the crucial part of this discussion. What happens to the ‘mid-spend’ segment of the restaurant sector? I’m pretty certain, its customer base will feel a squeeze on its disposable income. Some of this squeeze will involve foregoing a restaurant meal or two.

And, when people at this level of income go out, because it will be a less frequent occasion than previously, they may decide they want better value. The implication of this is that mid spend restaurants will need to up their game in terms of quality, service and all the other things that make going to a restaurant a memorable event, and one that encourages a return visit or a recommendation to a friend.

But this search for quality may also prompt customers to spend more; in other words they may transfer their three monthly restaurant meals in mid-spend restaurants, to two meals on which they will spend more (and possibly, by the by, actually spend less in aggregate over a month). That’s a theory and we’ll see if it turns out to be true.

But I expect there will be a squeeze on mid spend restaurants from its customers seeking higher value. This search may alight on a generally more expensive restaurant – or, crucially, on measurably improved value from their normal repertoire of mid spend restaurants. In essence, customers may continue to frequent their former preferred restaurants – but they will only do so as long as the offer is of sufficient quality – food, ambience, service and the many other things that make for ‘quality’.

But there is another theory too: there may be less of a move away from restaurants towards lower priced places than some would think. Will the customer of a mid-spend restaurant, move down and spend less when eating out? Well of course they might and some, undoubtedly, will. But there is a qualitative, experiential

What can operators do to mitigate price increases?

In the face of the squeezed middle, restaurants need to maintain margins while costs rise and selling prices need to be kept under control

- Reduce portion sizes
- Reduce quality
- Require customers to pay for items that were formerly part of the ‘menu price’

Some of these things that operators can do may upset customers and therefore may not be good business. Other things can be more subtle:

- Create new menu items at lower price points
- Repackage former menu items
- Present change as something else – Just Eat have just introduced a ‘waste less’ option – let the customer chose to have smaller portions
- Remove the most expensive options from the menu
- Provide value by providing additional products at no extra cost to the customer – free coffee works
- Present smaller quantities in such a way that maintains ‘plate cover’

difference between eating in a restaurant with table service and being served at a fast food counter.

Some brands, successfully straddle this divide – I would note Nando's in particular – but in my view, it would be a stretch to expect most customers to switch an occasion that involves eating a full service meal for a fast food meal.

But it's not all that simple

It's here that another consideration comes into play. Restaurant customers don't fall into simple categories – it's not the case that this customer always spends £7 a meal, that one always spends £27. Its also to do with occasion. Take two customers who would both spend between £7 and £27 a meal; for one customer it's an average of £10; and for another customer it's an average of £20 a meal.

What this means is that it's the offering that is important, rather than the customer per se.

And I would suggest that what restaurant operators need to do is ensure that they deliver this value whether it's a £7 meal or one costing £27 – the value being appropriate to the price but value, nonetheless.

But, you will no doubt say, that's always been true, what's different now? The answer is quite simply, that 'value' will be reinterpreted – it has been, unfortunately, true for quite a few years that quality could have been of low (or variable) value but the customer wasn't too bothered, so long as they had a convivial meal (after all, it was enjoying time with their friends that made it so, not the restaurant) and provided the bill at the end wasn't too much. Restaurant operators were able to get away with adequate (or poor) quality.

But now, that will no longer be good enough. Like many people, I am hearing many horror stories of restaurants offering shoddy, aggressive, or unhelpful service (no doubt this is exacerbated by the recruitment of staff who lack the necessary interpersonal skills – because the people with those skills are no longer so readily available for employment in a restaurant). That will have to improve.

Is there going to be a squeezed middle?

It may be difficult to destrand the arguments I have put forward and arrive at a useful answer.

My view is that there will be a squeeze right across the restaurant market – from the most humble kebab-shop, to the top end West End restaurant catering to Russian oligarchs. But the pain will be most keenly felt in the mid spend segment (because some of its meal occasions will, perhaps as I have argued, surprisingly migrate upwards). This is the largest segment, and it will suffer both the largest fall in £s and in %age terms.

But here is an important point: operators in the higher and the mid spend segments will benefit from the falling numbers of outlet in their segments – probably 15% or so since the start of covid.

And the lower end segment is already seeing an upsurge in demand driven by the success of delivery and the opening of outlets in new types of location – such as drive throughs, and suburbs where working from home customers are spending more of their time.

But over the coming years, the benefits from falling numbers of outlets will be negated with the opening of new restaurants (because fundamentally there will be a new generation of entrepreneurs who want to invest in their own restaurant or grow a new chain. That has been the case for many years, and since hope springs eternal and the cost of entry is relatively low, new restaurant openings are inevitable. They will add to the stock and will, ultimately, once again give rise to the overcapacity that was beginning to be a feature of the market prior to covid. The point of this is that unless growing demand keeps up with the pace of net store openings, the revenue available for each outlet falls. That is a threat for the future but not for the here and now.

The lower end will also suffer because of falling meal occasions taken by those customers suffering the most egregious hits to their income – and these lower end operations (independents and chains alike) may not be fully compensated by a downward migration of meal occasions from former, mid-spend occasions.

And there will be other changes too. Quality, and value, will improve where it can; and where it can't, the restaurant will suffer falling sales.

How long will this state of affairs last? My guess is: years.

In conclusion

There is going to be a sort of squeezed middle in the restaurant sector.

Those restaurants in the competitive mid spend segment will collectively note a drop in sales but they will individually be shielded from this fall by the reduction in outlet numbers that started two years ago.

At the same time, custom within the mid-spend segment will migrate within the segment, to those operations that offer value and quality. Difficult concepts to nail down but essential, in my view, for continuing success.

If you want to know any more, or if you have any comments, or concerns, please contact me on 07785 242809 or at peter@peterbackmanfs.com

The remainder of this Monthly Briefing Report contains a brief summary of corporate activity over the medium and long term that has been reported in the past month. There has been a notable rash of reporting of figures that cover the early months of covid – it would seem that the 'financial reporting' decks are being cleared for reporting much improved figures for 2022.

News in the month

Restaurants

- Various Eateries LfL sales grew 21% versus 2019 in the period from reopening in May 2021 to end October 2021
- Tasty sales in calendar 2021 rose 44.2% versus 2020
- Hostmore sales in calendar 2021 rose 23.2% versus 2020
- The Restaurant Group revenue in calendar 2021 rose 38.4% versus 2020
- Mowgli sales to end July 2021 fell -23.9% versus 2020
- Iberica sales in the year to end September 2020 fell -42.5% versus 2019
- Spaghetti House sales in the year to end March 2021 fell -88.7% versus 2020

QSR

- Domino's Pizza Group sales in calendar 2021 rose 11.2% versus 2020
- Gregg's sales in calendar 2021 rose 5.3% versus 2019
- Wasabi sales in calendar 2021 fell -56.7% versus 2019
- AMT Coffee revenue in calendar 2021 fell -63.4% versus 2020
- Crussh sales in the year to end March 2021 fell -78.6% versus 2020
- Starbucks UK sales in the year to end October 2021 rose 35% versus 2020

Pubs

- Thornbridge Brewery sales rose 8.3% in the year to end June 2021 versus 2020
- Dorbiere sales to end September 2021 fell -23.6% versus 2020
- We Are Bar Group sales to end September 2020 fell -55.9% versus 2019
- Hopback Brewery sales in the year to end September 2021 fell – 36.4% versus 2020
- Drake & Morgan sales in the year to end March 2021 fell -90% versus 2020

Suppliers

- Fever Tree Drinks sales rose 23% in calendar 2021 versus 2019
- AG Barr sales in the year to end January 2022 rose 18.3% versus 2021

Around the World

- GLH Hotels sales in the year to end June 2021 fell -92% versus 2020
- Time Out Markets sales in the last six months of 2021 rose 295% versus 2020
- Hostelworld Group sales in calendar 2021 rose 9.7% versus 2020

Around the World Delivery

- Deliveroo total revenue in calendar 2021 rose 57% versus 2020

Delivery

- Deliveroo UK & Ireland revenue in calendar 2021 rose 64% versus 2020