



**Fáilte Ireland**

National Tourism Development Authority

# The Cost of Food Preparation & Service Activities in the Hospitality Sector

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# The Cost of Food Preparation & Service in the Restaurant Sector

1	Introduction .....	1
2	Objectives .....	2
3	Approach & Method .....	3
4	Key Findings .....	4
5	Next Steps.....	7
6	Summing Up .....	12
	APPENDIX 1: CONSULTANTS REPORT.....	14

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# The Cost of Food Preparation & Service in the Restaurant Sector

## Summary Paper

### 1 Introduction

Fáilte Ireland is the National Tourism Development Authority, established by the government in May 2003 to guide and promote the development of tourism as a leading component of the Irish economy. To this end, Fáilte Ireland, working in partnership with the tourism industry, provides an extensive range of support services designed specifically to develop and sustain Ireland as a high-quality and competitive tourism destination. Our vision for Irish tourism is that of a dynamic, innovative, sustainable and highly regarded sector offering international and domestic visitors a positive and memorable experience beyond their expectations.

Eating out is an integral element within the tourism experience, yet for a number of years visitor surveys have revealed a significant level of dissatisfaction relating to the perceived value for money of the food offering. Although this issue has surfaced occasionally in the national media, little empirical evidence exists around food production costs, nor has there been any rigorous quantitative analysis of the issue. Consequently, debate on this subject is not as well-informed as it might be. Hence, Fáilte Ireland commissioned independent research with the intention of developing insights into food production and preparation costs in the hotel and restaurant sector. Horwath Bastow Charleton was engaged to undertake the project research and their detailed report is attached as Appendix 1

Before describing the project approach and findings, it is important to understand the composition and structure of the restaurant sector in Ireland. There were an estimated 2,500 licensed restaurants operating in Ireland in 2008, with an average capacity of 82 covers, and an average employment of 15 persons year-round (including both full-time and part-time). The restaurant industry therefore is a sector comprised mainly of SMEs, and indeed might more accurately be described as a sector of micro-enterprises. Not surprisingly, these micro-enterprises share many features with micro-enterprises operating in other sectors across the Irish economy. The most significant of these are that micro-enterprises tend to be owner-managed, they are frequently overly focused on operational issues, and some have a limited

capacity for quantitative business analysis.

A consequence of this industry structure and composition is that it can be difficult to gather good analytical data about the restaurant sector. In recent years a number of attempts have been made to undertake a comprehensive business analysis of the sector, but these projects have struggled to gain traction either because restaurants did not have time to engage in the survey process, or because they did not have the data to respond to the questions asked, or indeed both. In the present case, a more limited approach was undertaken and this is described below. The value of this approach has been that we have been able to do some analysis and secure some good insights into the cost of doing business in the restaurant sector. The down-side however is that we cannot claim that these insights are final or conclusive. What we have are some indicators that allow us to understand the broad composition of the cost base, but further work will be required before we can make any more definite comment. Over the next few years, Fáilte Ireland will continue to work with the restaurant industry in order to develop stronger insights into the costs of doing business in the sector.

## **2 Objectives**

The objective of this study was to analyse and report on the “production function” and related issues that characterise meal preparation and food service operations in the hotel and restaurant sector. To this end, the study was split into three component parts as follows.

### *Part 1: Identify Inputs and Estimate Relative Weights*

The aim of Part 1 was to develop insights into food production costs in the hotel and restaurant sector and to consider the impact of government regulation as a cost driver in the sector.

The study presents a quantified analysis of the correlation between a defined unit of output (a standard meal), and the associated set of inputs required to produce that unit of output. The identification and unit cost estimation includes an analysis, inter alia, of the following input headings:

(a) Raw materials costs

- (b) Labour costs
- (c) Regulatory burden
- (d) Utility costs
- (e) Fixed and overheads costs.

In addition, the project assesses how those consulted felt the regulatory burden has changed over the last five years and what impact this is having, if any, on the cost and price of a standard meal.

#### *Part 2: Cost Behaviour*

The aim of Part 2 was to develop insights into the degree of cost control within the sector. For each of the unit costs identified and grouped into an input heading (as set out above) the study examines and classifies the behaviour of that unit cost in response to changes in the number of meals produced.

#### *Part 3: International Benchmarking*

The aim of Part 3 was to benchmark Ireland and set a broader context on the analysis. Across the input headings identified, a desk-based comparative review benchmarks the unit cost base in the Irish hotel and restaurant sector against equivalent sectors in other relevant and comparable countries.

### **3 Approach & Method**

In the absence of quantitative sectoral data from official sources, this study sought to capture the necessary data through a series of case studies. The primary research was conducted through a comprehensive topic list which was discussed in detail with a sample of 26 restaurants (14 stand-alone and 12 hotels based). The focus was on “mid-priced” restaurants as these are the types of establishments most often frequented by tourists when eating out. In addition, a short questionnaire was sent to a larger sample of restaurants to get a wider base for the quantitative analysis.

The co-operation and assistance of the Irish Hotels Federation (IHF) and the Restaurants Association of Ireland (RAI) was invaluable as the research participants were drawn from the membership of these bodies. The case study questionnaire and the shorter form questionnaire were developed in collaboration with the RAI and IHF.

Owing to the study's information needs, only restaurants with the appropriate level of financial and management data were eligible for inclusion. This may imply that the research participants were drawn from establishments with better management and business information structures; however, there is no way of testing this assumption.

The selected restaurants represented a wide geographic mix, with both urban and rural locations represented. In total nine participants were from Dublin with the remainder from counties Cork, Galway, Kerry, Mayo, Waterford, Westmeath and Sligo.

**Table 1: Case Study Participants**

County	Stand-Alone Restaurants	Restaurants Attached to a Hotel	Combined Total
Dublin	6	3	9
Cork	2	2	4
Galway	1	-	1
Waterford	1	4	5
Kerry	1	1	2
Mayo & Sligo	3	-	3
Westmeath & Offaly	-	2	2
Total	14	12	26

The international benchmarking element of the study drew on secondary data sources relying on existing published reports, articles, and data from official sources across the key source markets for the Irish tourist industry. This work was done to position the industry in a wider international context.

## 4 Key Findings

On the basis of the approach adopted, we were able to generate insights into the cost of doing business in the restaurant sector and the key findings are presented below.

### 4.1 Input Costs

The findings of this study suggest that the price of a standard meal<sup>1</sup> can be readily

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<sup>1</sup> For the purpose of this study the concept of a standard meal was developed and is understood to mean a typical beef, chicken or fish dish inclusive of vegetables, sauce, garnish and other non-beverage accompaniments.

traced back to the principal input costs required to produce it. The table below presents these component inputs as a percentage of the selling price of a standard meal.

**Table 2: Cost Components of a Meal**

Component	Percentage of Sales Price Incl VAT	Percentage of Sales Price Excl VAT
Raw Materials	31%	37%
Labour Costs	25%	30%
Fixed Costs	14%	17%
VAT & Excise	17%	--
Residual <sup>2</sup>	<u>13%</u>	<u>16%</u>
Sales Price	100.0%	100.0%

4.1.1 Raw Materials (Food and Beverage Inputs)      31% incl VAT

Perhaps unsurprisingly, food and beverage inputs are the largest single cost component. The vast majority of restaurants use fresh, premium foods rather than less expensive lower quality options. Suppliers are selected based on a range of factors, e.g., product quality, product source and continuity of supply and price.

4.1.2 Labour Costs      25% incl VAT

Labour costs account for a considerable portion of the overall cost structure within a restaurant. Pay rates in the sector are governed by a significant body of legislation, and the minimum remuneration for the sector is set by a system of Joint Labour Committees (JLC). It is important to note that the JLC regulations have consistently set rates of pay for the sector above the national minimum wage.

4.1.3 Fixed Costs (Utilities and Overheads)      14% incl VAT

The other significant costs incurred by the restaurant sector are operational costs (e.g. tablecloths, tableware, cleaning products, etc.), utility costs (e.g. electricity, gas, waste, local authority rates and water charges) and administrative overheads (such as repairs, maintenance, insurance and sales and marketing). Utility costs in particular have grown faster than general inflation.

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<sup>2</sup> This residual figure is comprised of four main elements: rent or lease costs, depreciation charges, taxation, and profit.

#### 4.1.4 VAT & Excise 17% incl VAT

The beverage element of a meal is impacted by high VAT rates (21.5%) and the highest excise rates in Europe (€2.46 on a standard bottle of wine). The food component of the meal is subject to 13.5% VAT.

#### 4.1.5 Residual Components 13%

The balance of 13% is a residual sum available to the restaurateur to cover property costs (either owned or rented – in other words mortgage or lease payments), capital expenditure on equipment and fittings, taxation and profit. This led the project consultants to conclude that there was no evidence to support a view that excessive profits were being generated in the restaurant sector.

### **4.2 Cost Behaviour, Cost Control & Cost Management**

The research suggests that 47% (see Appendix 1 for more details) of the cost of a meal is either fixed or semi-fixed (before taking into account property related costs and maintenance which are also essentially fixed). The restaurant sector is therefore very vulnerable to fluctuations in demand as fixed costs need to be spread over as many covers/customers as possible. All restaurants experience some fluctuation in demand across the week, with peak demand commonly experienced over the weekend. Restaurants also experience seasonal demand which differs from location to location. Typically, busier periods cross-subsidise the quieter ones and taken in combination, produce the figures shown above.

### **4.3 Regulatory Burden**

The research also suggests that restaurants bear a significant regulatory burden that adds to their cost base. Restaurants have embraced stringent food safety and hygiene requirements and there is a very high degree of compliance within the industry. However, according to the majority of respondents the increased regulatory burden has had an overall negative impact on their businesses, particularly by increasing staffing requirements, general cost imposition, and diverting owners/managers away from customer facing activities.

### **4.4 International Benchmarking**

Irish restaurants are subject to input costs which are higher than in many peer countries. For example, EU wide data on input and consumer prices show that:

- Irish restaurants face higher VAT charges on alcoholic products. In fact Irish VAT rates are significantly above the rates observed in the benchmark countries.
- Food and beverage costs in Ireland are some 21% to 30% higher than the average for the 27 EU states. This implies that Irish restaurants have to deal with the highest food and beverage costs across the reference countries examined.
- Ireland has the highest excise duty on alcoholic products in the EU which drives the beverage cost base well above the average.
- Ireland has higher labour and energy costs than those observed in the benchmark countries, which again drives up the cost base.

#### **4.5 Conclusion**

The study's findings do not support a view that the restaurant sector is engaged in excess profit taking (a point of view which is occasionally presented in the media and in public commentary). The study suggests that the price of a standard meal is directly influenced by the input costs required to deliver that meal and the normal requirement for a business return reflecting business risks. Based on the findings derived from this study, there is no evidence that firms in the restaurant sector are making above normal profits (or super-normal profits as described in economics literature).

In a comparative context, the cost of a restaurant meal in Ireland appears to be driven by input costs that are higher than similar input costs in other countries. In responding to this cost environment, and in order to address the negative perceptions of some consumers, there are two broad ways for the restaurant sector to address the perception that value for money could be improved. These are:

- A focus on reducing costs.
- A focusing on improving efficiency.

We now turn to the next step and how the sector can improve value-for-money.

## **5 Next Steps**

### **5.1 Focus on Reducing Costs**

Tackling high costs in the restaurant sector is challenging. While the recent economic slowdown has moderated cost pressures and, in some cases, led to cost reductions, concerted action will nevertheless still be required on the part of restaurant

owners/managers to contain costs. Such measures are likely to include:

#### 5.1.1 Raw Materials

Such costs, even before VAT and excise, are above the EU average. The reasons why meat, fish, fruit and vegetables cost so much more in Ireland need to be examined. One possibility is that there may be rigidities in the distribution chain. The Competition Authority published, in May 2009, a Retail-related Import and Distribution Study. It states that a number of factors contribute to prices differentials between Ireland and elsewhere; these are: the cost of doing business, scale, tax regimes, consumer's incomes and tastes, levels of competition and regulations. All of these affect pricing decisions. The Competition Authority found that supply chain structures generally react to changing consumer behaviour. Their main finding was that the best way to ensure that Irish businesses are capable of competing is to tackle the factors that contribute to Ireland's higher cost of doing business, e.g. utility, labour and other costs. Reducing the cost of doing business will help to bring down the cost of raw materials.

#### 5.1.2 Labour

Labour accounts for a considerable portion of the overall cost base within a restaurant. There is some evidence to suggest that labour costs may be even higher than this study indicates once supervision and oversight costs are taken into account. JLC regulations set a floor on the wage rates in the sector above the statutory minimum wage. Those involved in any future reviews of JLC rates must remain mindful that the minimum wage is set as a wage floor in the national labour market, and not as a platform on top of which catering and hotel JLC rates can continuously extend.

#### 5.1.3 Utilities

Utility costs have increased at rates far above general inflation. Ireland's electricity and energy costs are amongst the highest in the eurozone. While these costs have fallen recently, Forfás has noted that improving energy efficiency, market reforms and investing in strategic infrastructure could contribute significantly to improving Ireland's energy cost competitiveness.

With regard to local authority charges (rates, water services, waste services etc), the

sample case studies conducted in this study presented some concerns about the clarity and consistency through which these charges are determined. Many of the restaurants consulted seemed unaware of how their local authority commercial rates and water, waste and other charges were calculated. Consequently, some concern was expressed that local authorities could cross-subsidise other expenditure programmes through the introduction of water charges. As not-for-profit agencies, local authorities seek only to recover the full economic cost (capital and current) of non-domestic water provision. With the introduction of non-domestic water charges, restaurateurs expected some corresponding drop in commercial rates, yet this did not happen. Whilst it was acknowledged that the expected drop in rates might not necessarily fully match the service charge, some cost adjustment was nevertheless anticipated. A further area of concern to emerge from the study was what was referred to as the large and unexplained difference in charges, especially water charges, being applied across different local authorities. As a general point, greater consistency of approach, more clarity regarding the precise methodologies used in setting charges, and better communication on the part of local authorities will help the restaurant sector understand how such charges are levied.

Further efforts should be made to *a)* reduce costs in the provision of public-sector managed services, and *b)* ensure that service charges reflect only the economic cost of efficient service delivery. At enterprise level, efficient usage of water and energy will help to control costs.

#### 5.1.4 Regulatory Burden

Easing the administrative burden associated with government regulation brings significant benefits to SMEs by reducing business costs, reducing owner/manager's time spent on non-customer facing activities, and thereby increasing productivity. Recent developments such as subjecting the introduction of new regulations to a regulatory impact analysis and the Better Regulation target of reducing administrative burdens by 25% by 2012 are most welcome.

## **5.2 Focus on Improving Efficiency**

Fáilte Ireland works continually with the hospitality sector, and the wider tourism industry, on ways and means of making business operations more efficient and effective. Fáilte Ireland provides a suite of business support services targeted at all

types of tourism enterprises and also runs a number of restaurant sector focused programmes.

#### 5.2.1 Fáilte Ireland's Tourism Enterprise Supports

In terms of tourism business supports, the following programmes have been designed by Fáilte Ireland to assist in improving operational efficiency:

*Business Mentoring and Coaching Service:* designed to provide specialist, tailored support and advice. The service offers, amongst other things, expert guidance on a wide range of business needs and objective and independent advice on all areas of business. The aim of the service is to improve operational performance and increase management capacity.

*Business Advisory Service:* provides consulting, advisory and mentoring services to tourism enterprises, designed to encourage the adoption of managerial and operational excellence throughout all aspects of the tourism enterprise, with a view to achieving increased efficiency and profitability.

*Optimus/Best Practice Programme:* is a multi-tiered programme to support tourism businesses in becoming more profitable, more efficient and more competitive. Comprising three distinct yet inter-related elements, Optimus focuses on every aspect of the business from customer service to operational management to organisational excellence. One component of the programme focuses on operations, in order to provide customers with a value-for-money experience.

*Performance Plus:* is a comprehensive 'one stop shop' databank of interactive benchmarking and informational activities for key operational areas within tourism enterprises. Password protected users can go on-line and, on a confidential basis, compare their business performance against other tourism enterprises that have signed up to the database. Performance Plus currently hosts a number of channels that will be further expanded over time, such as:

- Finance: hotels can compare their own performance with regularly updated sectoral averages.
- Environmental Cost Management: provides guidance and self-audit tests in such areas as environmentally friendly purchasing, efficient water and energy

consumption and waste disposal. While the emphasis is on cost-saving, users are encouraged to consider working towards achieving an award and environmental certification.

- Energy Management: hotels can benchmark their own energy usage and costs with other participating hotels and can also receive tailored advice on efficient energy management.

### 5.2.2 Fáilte Ireland's Restaurant Sector Specific Supports

Fáilte Ireland offers a number of programmes specifically for restaurants focusing on operational efficiency and productivity so that firms are well placed to provide tourists with a better 'value experience'. These include:

*Chefs Workshop Programme - Sweat the Menu, Reduce the Cost & Savour the Profit:* a nationally run, highly relevant, workshop designed to give participants an overview of the essential elements of kitchen cost savings and menu design for profit. It is very much a re-focus on the fundamentals that all kitchens teams must practice. Areas addressed include:

- Raw material food cost via smarter purchasing (e.g. supplier price agreements, better product specifications, tendering, etc.) as well as correct food costing.
- Cost of production control through better management of energy, waste control (in preparation, cooking and service), water management and improved labour efficiencies in kitchens.
- Menu Pricing & Menu Engineering Reviews to reduce extensive menus and thereby stock levels; to remove extensive and ineffective dishes or labour intensive dishes; to reduce dishes with poor contribution margins and offer instead more effective and better value dishes.

*Front-of-House Productivity Programme:* another area to improve efficiencies is making front-of-house staff more productive, through better menu knowledge and awareness of the role they play in the overall service experience from the time the customer enters the restaurant. Good knowledge of the menu, dishes, ingredients, cooking methods and food presentation will all influence how staff can best guide and advise the customer. For example, if the staff can confidently recommend a wine, they will then engage the customer more. When the customer's experience is better, although they may spend more, they generally feel that they are getting better value

for money. Value for money is not always about offering the cheapest meal but can also include elements relating to how positive, unique and memorable the dining experience was.

*Quality Food Toolkit:* is designed to support the full range of food operations servicing the tourism industry including pubs, clubs, restaurants, visitor attractions, bed and breakfasts and guesthouses. The toolkit provides food operations with a range of resources that assist in improving visitor satisfaction in terms of food quality, use of local ingredients, presentation standards and value for money. The CD resource includes:

- A creative range of recipes and food presentation ideas.
- Advice in relation to operating food hygiene and managing food safety.
- Guideline recipe costings to assist in purchasing and pricing decisions
- A profit margin calculator.
- A facility to tailor recipe costs to reflect supplier prices and target profit margins.
- The option for businesses to add their own signature dishes to the range of costed standardised recipes.

## **6 Summing Up**

Based on the case studies conducted, this research suggests that that the restaurant sector is not engaged in excess profit taking. This implies that concern about value-for-money must be understood to be rooted in the sector's high cost base. The international benchmarking exercise and national competitiveness studies lends credibility to this view. There are two broad ways for the restaurant sector to improve value for money – managing costs and improving efficiency.

Given that the sector operates in the context of the wider Irish economy and that its cost base is therefore largely determined by developments at national level, efforts to reduce costs must take place in the first instance at national level. The recent economic downturn has led to a renewed emphasis on regaining competitiveness and has prompted a national cost reduction effort. The restaurant sector can benefit from this.

Like all businesses in the current economic climate, and most importantly for SMEs and microenterprises in the tourism sector, improving operational efficiency must move to centre stage as the single point of focus. Through its own programmes and

support services, Fáilte Ireland will support this focus and will work with these firms to help them survive the recession and emerge prepared to take advantage of the anticipated upturn in the medium term. Thus, the recommendations/actions arising are as follows:

1. Fáilte Ireland will undertake a study into the regulatory burden imposed on Irish hotels and restaurants. This study will examine how various legislative requirements are imposed in Ireland relative to competitor countries and the effect that this is having on business costs.
2. Those involved in any future reviews of hotel and catering JLC rates must remain mindful that the minimum wage is set as a wage floor in the national labour market, and not as a platform on top of which JLC rates can continuously extend.
3. With regard to local authority charges, greater consistency of approach, more clarity regarding the precise methodologies used in setting charges, and better communication on the part of local authorities will help the restaurant sector understand how such charges are levied.
4. Further efforts should be made to *a)* reduce costs in the provision of public-sector managed services, and *b)* ensure that service charges reflect only the economic cost of efficient service delivery.
5. Fáilte Ireland will continue to resource, as a priority, operational efficiency and productivity programmes specifically tailored for restaurants.

## **APPENDIX 1: CONSULTANTS REPORT**