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Impact of High Menu Pricing on Sales

From Subject Matter Expert, Joe Pawlak, Managing Principal

Foodservice is experiencing its first slowdown since March 2020 when the COVID-19 pandemic abruptly and, for all intents and purposes, shut down the industry. Although not nearly as dramatic, right now we are seeing sales and traffic drop-offs in many industry sectors. After more than two years of post-pandemic recovery-propelled growth, consumer visit frequency and spending are down, resulting in subpar company performance, a slew of bankruptcies and anxiety across the industry.

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So, what is instigating this slowdown? The good news is that longer-term fundamentals that favor away-from-home meals still haven't changed: needs for convenience and experiences; cravings satisfaction; and demand for unique foods/beverages. As with almost all foodservice sector slowdowns, this one can be attributed to economic factors. Usually, a notable drop-off in gross domestic product, employment, disposable personal income or consumer confidence starts the cycle of industry sluggishness. But this time, weakening of these economic indicators is not to blame. Rather, menu price inflation is the culprit.

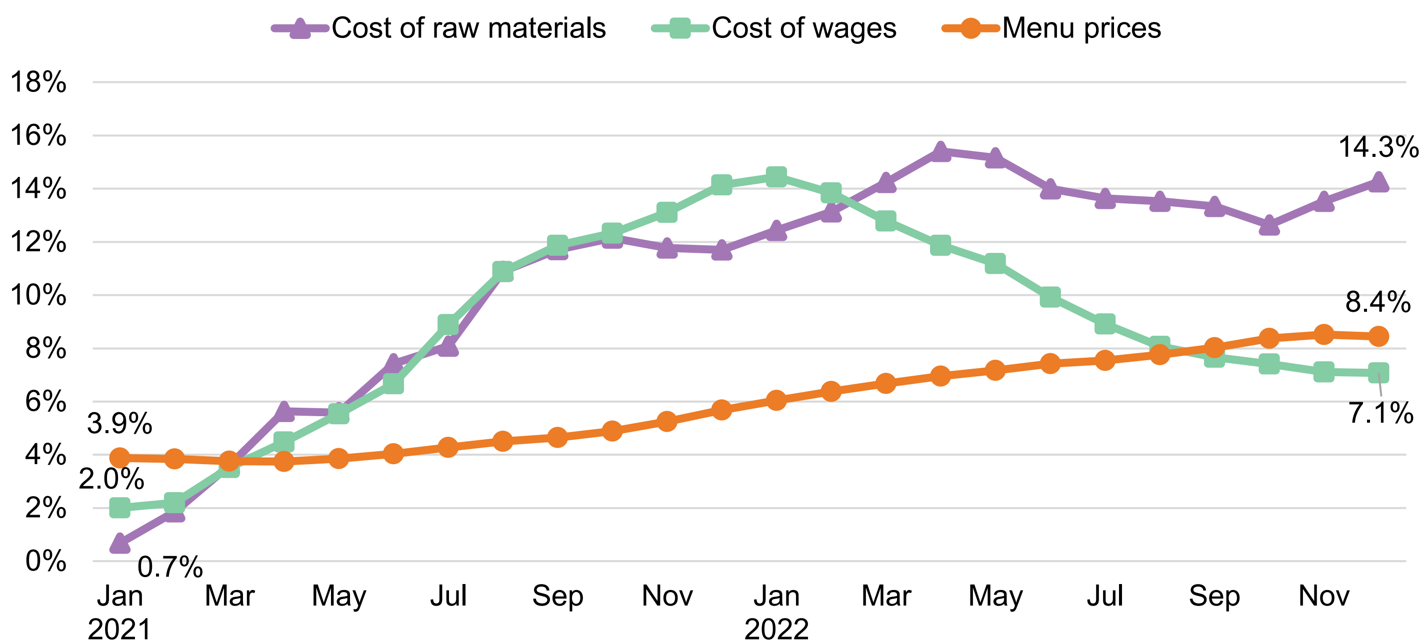
Unless you've been living under a rock for the last two-plus years (or just haven't gone out to eat), menu prices have gone sky high. And consumers have finally had enough. In this brief, we'll look at the forces behind menu price proliferation, its impact on the consumer and what the industry is doing now to turn the tides.

A Little History

Let's go back to early 2021. A vaccine was made available, businesses were reopening, and Americans became more confident in gathering in public places and joining group events. Foodservice began its historic recovery triggered by pent-up demand. This, however, did not come without complications. The industry was caught flatfooted (as were many others) at the time. Manufacturing capacity and supply chain disruptions resulted in significant product shortages, which drove food, beverage and nonfood costs to record highs. Wage increases spiked as finding labor was next to impossible.

With operator prime costs (wages plus raw materials, which represent about 70% of total costs) jumping, operators needed to take their prices up significantly just to make ends meet in 2021 and 2022. As a comparison, the pre-pandemic 20-year annual average on menu price increases is 2.9%. *(See Exhibit 1)*

EXHIBIT 1: MONTHLY YEAR-OVER-YEAR CHANGE (THREE-MONTH MOVING AVERAGE)



Source: St. Louis FED (FRED)

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However, menu price inflation was not problematic for the industry in 2022 and first half of 2023. The industry continued to experience strong results started in March 2021 during this period. Reasons include:

Residual pent-up demand
There was still pent-up demand being released for eating out through this time period.

Context
Menu prices alone weren't jumping at this time. Virtually every U.S. business was charging more for their products and services in 2022 and 2023 due to the same factors, supply chain disruption and labor shortages. In fact, total U.S. inflation for 2022 and 2023 was reported at 8.0% and 4.7%, respectively, against a 20-year average of 2.1%. Grocery prices were up dramatically as well. From late 2021 and into early 2023, grocery price inflation was outpacing menu price inflation.

Empathy
Consumers were sympathetic to the plight of operators, knowing they had experienced a very difficult time in 2000 and early 2021. Industry-driven communications promoting dining out were successful in driving home this fact, and consumers reacted positively.

Available cash
Consumers still had excess disposable income from additional savings and government stimulus from the pandemic, which they continued to spend.

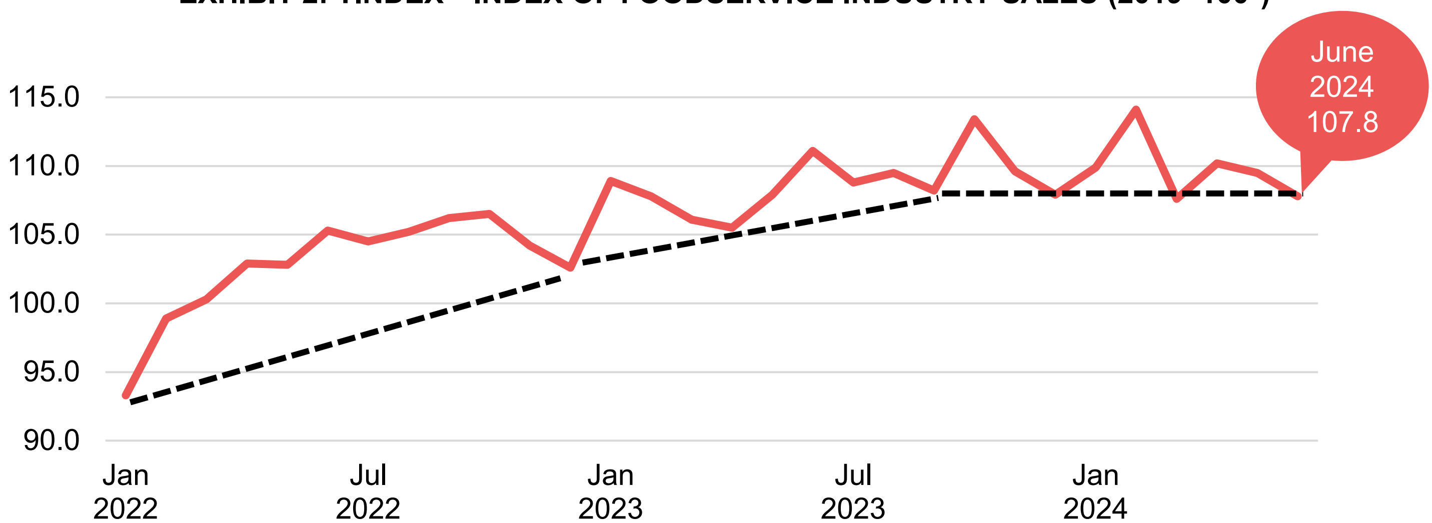
What Has Happened Since

2023 started off strongly for the industry as good weather nationwide and post-pandemic exuberance continued. But in Q2 2023, a shift began that started a flattening sales trend for the industry. (See Exhibit 2)

If we look at the four elements that drove industry growth despite inflation in 2022 and 2023, those had been either mitigated or eliminated.

First of all, pent-up demand waned. Its impact had mostly been eliminated by the time 2023 rolled around. Consumers' habits normalized, although these may have been altered since 2019. Secondly, consumers spent all their accumulated cash. Conversely, consumer debt levels started to rise.

EXHIBIT 2: TINDEX—INDEX OF FOODSERVICE INDUSTRY SALES (2019=100*)



Source: Technomic TIndex
*Note: Each month's index corresponds to the same month in 2019 where the index=100

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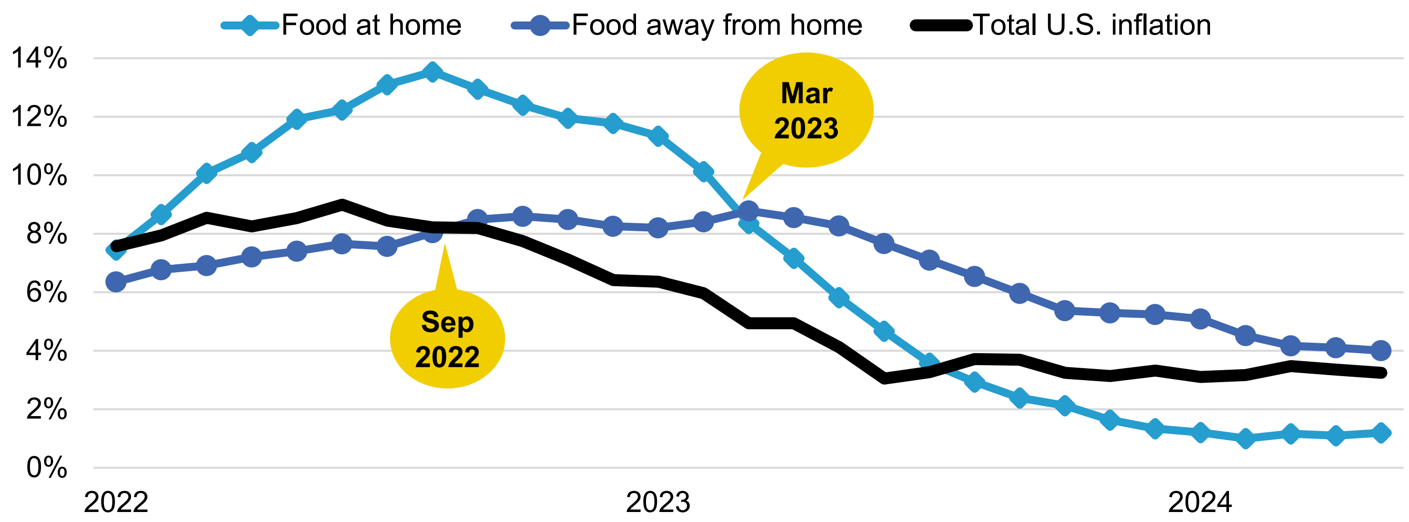
EXHIBIT 3: MONTHLY YOY CHANGE IN U.S. CONSUMER PRICE INDICES (INFLATION)



Source: U.S. Bureau of Labor Statistics

Thirdly, context changed. As early as Q3 2022, events were set in motion, putting inflated menu pricing under the microscope. Overall U.S. inflation began dropping in July 2022 while menu price inflation continued to accelerate. In September, there was an inflection point where menu price inflation exceeded total U.S. inflation for the first time since early 2021. There was a similar inflection point on grocery prices, where menu price inflation exceeded grocery price inflation (in March 2023). *(See Exhibit 3)*

Consumers now started to see that price increases were decelerating more broadly in the economy, and when looking at trade-offs, even more sharply in retail grocery. Although menu prices were also decelerating, this was happening very slowly and rates remained at historical highs. This put menu prices in a position of being in an expensive proposition comparatively.

And finally, operators depleted their consumer empathy bank. Consumers expected much more moderation in restaurant meal inflation as food cost increases decelerated (even dropped in a number of categories) and wage increases became more bearable. Add to that the proliferation of fees now appearing on checks and tipping now extending to limited-service restaurants, and consumers felt they were getting gouged.

2024—What's Happening Now

2024 brought about a tipping point for the industry, where the strongest signs of industry slowdown materialized. Same-store sales for many bellwether brands dropped dramatically. We saw notable brands declare bankruptcy, including Red Lobster, Rubio's, Buca di Beppo and Tijuana Flats. Distributor sales indicate that business is slowing through the broader market. All of these are a result of consumers being tapped out. Prices have become just too high to support the traffic and purchase activity reminiscent of post-pandemic times.

In a recent Technomic survey, 41% of consumers indicated they plan on decreasing their foodservice visit frequency vs. only 24% saying they plan on increasing frequency. Among those indicating they plan on decreasing frequency, the No. 1 reason is "prices are too high" (76% selected this as a reason). Put this in relation to the price of just about every other good and service is up since 2021 and consumers just have less money now to spend on food away from home.

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And it's not just lower-income groups that are hurting and spending less. According to a PYMNTS Intelligence report released in January 2024, 48% of consumers with incomes over $100,000 annually live paycheck to paycheck. Remember, this is the group of heavy foodservice spenders.

Righting the Ship

The industry has reverted back to an old formula to turn around its declining traffic and stagnating sales issues: dealing. Since the beginning of the year, operators have increased the number of deal-driven, limited-time offers. In January alone, these types of deals were up 114% over January 2023. Over the past few months, just about every major chain has introduced some form of price-driven promotion to reignite sales and boost traffic, from price-driven meal bundles to all-you-can-eat specials to BOGOs, just to name a few. We have embarked on a new round of "value wars."

There are really two goals that an operator is trying to achieve by introducing a price-driven promotion. The first is getting more customers through the door by enticing them with an attractive price or value proposition. But maybe more importantly, is once a customer is within the restaurant (or on the app), upselling them to a more premium offering or attracting with add-ons.

The question becomes how effective is this strategy in turning around weak results. If history repeats itself, the answer is "somewhat." These strategies will help drive sales in the short term with consumers tempted by the price and the value offered with the promotion. However, over a longer period of time, consumers become immune to promotions, and they almost become an expectation. Their effectiveness wanes, especially when everyone is offering one. And, right now, it's too early to tell if there is any sales bump occurring from the influx of deals. But it is also very difficult for individual operators to reduce or even stop dealing activity, especially if competitors continue to engage in this tactic. Once the value wars begin, they usually last a long time.

Smart strategists know that longer term, sustainable growth can not be driven by deals alone. It comes down to the fundamentals of building and strengthening their brands. Even in this challenging environment, there are operators that continue to employ this strategy, bucking the slowdown and posting strong results, including Chipotle, Wingstop, Dutch Bros Coffee, Texas Roadhouse, Popeyes and Dunkin'.

What are they doing? One of the key primers is product innovation and not just any form of innovation, but innovation that is truly meaningful in the minds of consumers. One example that comes to mind is Dutch Bros Coffee introducing protein lattes.

A second brand-strengthening fundamental revolves around differentiation. How is your brand different in the market and, maybe more importantly, is this differentiation meaningful? A great example of this is Wingstop, which recently introduced a crispy chicken sandwich to its menu. There is nothing really new or innovative with a chicken sandwich, as just about every limited-service burger and chicken operator has one on the menu. But, Wing Stop's point of difference is offering this product in 12 different flavors, whereas competitors typically offer one to two.

The last, and maybe the most basic of brand building and strengthening, is no compromising. Whether its the brand mission, business approach, customer promise or value proposition, brands should maintain a course that is consistent even throughout tough times. Strong brands also know that these times can be ideal to place even more focus on these factors, as competitors may be pulling back to cut costs.

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The Future

When do consumers start coming back? How long is this slowdown going to last? These are questions we at Technomic are hearing from our clients on a daily basis. Our current projections find that it will take a few quarters for short-term, deal-driven strategies to take hold, brand-strengthening efforts to engage and consumers to feel as though restaurants can offer good value again. This, of course, is based on economic factors holding steady at the time this brief was written.

One thing to keep in mind, is that the industry is extremely resilient, regardless of the situation. Over the past 50 years, the industry has seen only three years of sales decline (2009, 2010 and 2020). Consumers will always demand the convenience and experience that only foodservice can provide.

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