



Menu Pricing: What's the Percentage in Percentages?

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Since the dawn of food service time, management has focused on percentages as the primary approach for menu pricing. In other words, a target percentage is set for either the department, the entire menu, or in more sophisticated operations, for individual sections of the menu. An example might be pricing all items on the menu to result in a 35% food cost. Or pricing bottled wine to be a 40% cost.

Given flat sales or declining sales, perhaps the time is right to examine the fundamental flaws with the percentage approach. While it might be the easiest way to meet budget objectives – especially if the budget is set up with percentages; there are a number of problems with this approach. Using percentages:

1. Ignores contribution margin
2. Ignores the market
3. Requires frequent selling price adjustment due to recipe cost changes
4. Results in subjective personnel evaluation

You Can't Deposit Percentages

Percentages ignore contribution margins. The contribution margin is calculated by subtracting the menu item's cost from its selling price (that's the margin), and then multiplying by the number of that item sold (that's the contribution). Consider a steak dinner and a pasta dinner as examples. Assume the steak dinner sells for \$25 and costs \$10 (a 40% food cost). The margin would be \$15. If the pasta dinner sells for \$15 and costs \$5 (a 33% food cost), the margin would be \$10.

Food service managers might prefer to run a 33% food cost over a 40% food cost, but the bank refuses to accept percentages on deposit slips. So if we consider the cash, assuming we sold equal numbers of each dish, we would take more money to the bank from selling the steak dinner than from selling the pasta dinner, even though the pasta had a better food cost percentage. In fact, if we sold equal numbers of each, we would take 50% more to the bank from the steak dinners than from the pasta!

The real issue boils down to contribution margin. Using the above example, assume we sold 100 orders of each dish. The contribution margin from the steak dinner would be \$1500 (\$15 margin times 100 sold). The contribution margin from the pasta dish would be \$1000. Looking at it this way, it's easy to tell which item you like better.

The real trick to effective menu pricing is to examine and rank the contribution margins for each item on the menu and find ways to move the mix (number of items sold) around to get the highest possible contribution margin. Using this approach, you maximize profits without concern for percentages. Given the choice, wouldn't you rather own a restaurant with high profits and high food cost percentages than one with lower profits and lower food cost percentages?

Market – What Market?

Percentages ignore the world around the casino. While it may be true that casino guests are captive audiences, many come from the local area or are staying in the area if the casino does not have a hotel. If so, their decisions for where to eat, what to eat and the price they should pay (value) are partly based on their experience with nearby or similar restaurants.

For these reasons, it makes more sense to evaluate the local market and set up competitive venues in the casino. Many casinos consider food and beverage as an amenity, and therefore set their profitability expectations too low. But there is no reason the casino restaurants should be unprofitable. By focusing on the market and providing a venue that maintains a competitive quality and price level, casinos can achieve similar or better profitability than other operations in the market.

Note that this strategy does not consider cost percentages, but instead looks at competition as the driving force behind menu composition, quality and pricing decisions. If the basic assumption is that restaurants in the area must be profitable to survive, it stands to reason that emulating them should produce similar financial results. Just because a steak house operates at a 55% food cost doesn't mean it can't or won't be profitable. It all comes down to margin and volume.

Expectation Pricing Trumps Percentage Pricing

Setting menu prices to meet percentage objectives ignores contribution margin and competitive objectives. Fluctuating food costs make it difficult to maintain target percentages without constant menu price adjustment. Focusing on margin and volume takes the pressure off price changes since pricing is based on a determination of what the market will bear for the venue in question. Competitive restaurants don't typically change prices very often. Instead, they offer specials and other variable menu elements to balance cost fluctuation effects on profitability.

Offering products with higher margins, which can be accomplished by using less expensive foods, reducing portion sizes and implementing effective promotions to drive demand to those menu items can easily offset cost increases for signature dishes. Slight adjustments to portions and side choices for these dishes, along with intelligent placement and highlighting of menu items can also solve cost fluctuation problems. In any event, menu pricing that meet guest expectations for quality and value is far more profitable than focusing on percentages to determine pricing.

Bottled wine is a great example. It used to be normal to double or triple the retail price of wine for restaurant menus. With the recent rise in wine popularity, today's more sophisticated guests know what these wines cost in the stores, and are less willing to pay high prices for it. While they may buy the wine at a 20-30% markup, they would be less likely to buy it at a 100% markup. Of course, if the venue is targeting a 33% wine cost, management will find it difficult to swallow a 75% wine cost (excuse the pun). However, if the 75% wine cost results in \$2000 of profit while the 33% wine cost results in \$1000 profit – the proposed change seems more palatable.

After All is Said and Done...

At the end of the period, most operators look to the profit and loss statements, and more specifically the food and beverage cost percentages on those statements to determine if they are satisfied with the operation of the F&B department. In many cases, talented restaurant managers and chefs with well-controlled operations lose their jobs because the percentages are too high.

So many calculations go into these percentages that they are rarely correct, let alone any kind of objective indication of performance and talent. If we could know exactly what the food cost should have been based on sales, yields and recipes (not budgeted values), we would have a far better handle on performance. But food cost percentages alone are misleading. For example, a venue running a 60% food cost with a true ideal of 58% is better managed than one running

a 35% food cost with a true ideal of 31%. At the same volumes, the low food cost venue is losing twice as much as the high food cost venue! Which staff would you rather retain?

A focus on dollars of profit generated by the department is a much better indicator of ability. In addition, full-featured F&B systems that can identify waste, theft, overportioning and other variances specifically by item are far more indicative of performance than percentages could ever be. They typically also include menu engineering capabilities to rank contributions and identify menu strengths and weaknesses using these margins. The combination of control systems and margin-based, competitive menu structures will result in profitable, objectively managed operations.

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