The Lowdown on Downtrading

Shift from casual-dining establishments to c-stores could mean big gains

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The weakening economy's effect on the restaurant business has been a popular topic of conversation at Kwik Trip meetings. The biggest question, according to a KT official: "How do we grab a bigger piece of the pie?"

The pie Paul Servais refers to is a new class of foodservice consumer: the "downtrader."

"I believe [the downtraders] are here to stay. For all of us, our paychecks do not go as far as they used to, and this is teaching people to spend their money wiser," says Servais, foodservice zone leader for the La Crosse, Wis.-based retailer.

In its annual study "Eating Patterns in America," data-tracking firm The NPD Group, Port Washington, N.Y., identified consumers indeed forgoing casual-dining establishments for more reasonably priced options at convenience stores and QSR locations.

"There will be no recession in eating. There will only be winners and losers," says Harry Balzer, vice president of The NPD Group and author of "Eating Patterns in America."

It seems major restaurant chains have been on the losing end since the economy began to slow earlier this year. The Cheesecake Factory saw its stock down 54% in 2008. Chili's parent company Brinker International Inc. is reporting fiscal 2009 first quarter earnings per diluted share decreased to 23 cents from 34 cents in the prior year. Ruby Tuesday Inc. is down 84.72% from September through November. And the Wall Street Journal Restaurants and Bars Index is reporting a one year change of –28.40%.

Ron Paul, CEO and president of Chicago-based Technomic Inc., a research and consulting firm for restaurants, expects sluggish restaurant traffic well into '09. "We think it's going to be a pretty tough next seven, eight months, particularly as you move up the price spectrum," he says.

Dean Dirks of Dean Dirks Associates, Gig Harbor, Wash., cites this trend and concurs that it is trickling down to the convenience level. "Each level of dining is trading down to the next level: fine dining to casual, casual to fast casual, and fast casual to fast food," he says. "Fast feeders and convenience stores could be the big winners in the trade-down game."

WORD OF MOUTH: Sampling at Kwik Trip has been one of the retailer's strongest marketing tools. Each store samples a minimum of eight hours per week, pushing foodservice items as a way to grab any new potential consumers.

The Breakfast Club

Many foodservice retailers are finding that breakfast time is prime time for the downtrading consumer. From coffee to breakfast sandwiches, yogurt to fresh fruit, consumers dollar for dollar prefer the value of convenience first thing in the morning.

"The driving force in change is breakfast," says The NPD Group's Harry Balzer. Breakfast is the meal that Americans' are finding increasingly necessary from convenient food operators. "So if you ask where is the structural change still occurring in favor of foodservice, you'd have to say breakfast," he says.

Technomic CEO and president Ron Paul agrees that this is where convenience retailers stand to gain the most consumer crossover. "I think the entire retailer community has awakened to the fact that you can't keep losing meals to restaurants," he says. "And I think the opportunities for c-stores are still particularly strong around breakfast and lunch, when it's quick, hopefully make it easy-in and easy-out, small parking lot, easy to get to."

Mike Murphy, senior vice president of Whitehouse Station, N.J.-based Quick Chek, is finding that this rings true. "The morning portion of our business has been growing the strongest in breakfast sales," he says. "I think the key is coffee. We've got our people really focusing on it. Coffee has always been a staple of ours; we do very good coffee volume."

The experts agree that coffee is key, citing the fact that Starbucks seems to be suffering due to its high-priced image. Consumers may be seeing their morning latte purchase as too frivolous. Retailers such as Dunkin' Donuts have been very aggressive on this point, homing in on some of the coffee giant's market share.

"Starbucks' net profit was down 97% this last quarter and McDonald's same-store sales were up 5.3%," says Dean Dirks of Dean Dirks Associates. "McDonald's coffee and espresso program hurt Starbucks because of the trade-down market. From the retailers I talk to, the consumer trade-down is creating positive coffee growth, which grows customer counts."

Evaluating Performance

The question at this point is not: Does the downtrader exist? Rather, the topic of conversation at planning meetings across the country is: How do we get them into our stores for good?

Strategically speaking, Dirks says it's probably not in retailers' best interests to invest any capital despite the favorable forecast. "I would definitely stay away from any concept that a retailer has to spend capital on," he says. "To invest in a 100K equipment package for a new concept is dangerous because most retailers are looking for new income, not new losses."

Foodservice customers usually account for 20% of the total who walk through convenience-store doors on a daily basis. According to Dirks, c-stores with foodservice operations stand to grow 10% to 12% with the addition of the downtrading diner.

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He cautions, however, against taking this news to heart and revamping existing programs. Extensive site surveys and recalculations of ROI should be conducted prior to serious foodservice investment.

"If the ROI doesn't meet the owners' expectations, then you shouldn't move forward," he says. "An easy calculation is that if the investment won't pay for itself in five years, then you shouldn't do it."

For those retailers already heavily vested in foodservice, Dirks says a comprehensive review of labor should be conducted; hours of operation and pay rates should be evaluated. "The biggest wasted profit is in labor," he says.

Additionally, retailers should complete a cost-of-sales analysis that indicates, based on recipes and sales figures, the theoretical food cost vs. the actual food cost. "This exercise can save thousands of dollars," he says. "Once you find out the wasted dollars in food, adjustments can be made in menu pricing and best-practice preparation."

"Overinvesting to us is defined as running before we walk," Kwik Trip's Servais says. Any growth the company has experienced has been a long time coming, he says. Kwik Trip invested heavily in kitchen equipment, hot-holding display units for sandwiches and open-air coolers for fresh sandwiches and salads almost six years ago.

Today, Kwik Trip is revisiting space-challenged sites, eyeing ways to build a bigger prep area and expand the sales floor for food programs. "Because we know we can sell food at our stores, this is a good long-term investment for us," he says.

Formulating a Plan

Kwik Trip's interest in foodservice has little to do with trends or sour economies. Its investment is long-term and has garnered exceptional reviews in recent years. At the same time Servais does acknowledge that competitors and retailers across the channel will see how can they exploit ripples in the

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economy to capture new customers.

But lack of trendiness should not be misunderstood as being oblivious to today's growth opportunities. Kwik Trip's pricing strategy ties into pocket matters. The company's current marketing program, called Kwik and Low, focuses on "everyday values," such as three loaves of bread for $1.99 every day; bananas, potatoes and onions are 39 cents; junior cheeseburgers are two for $2.22; and 14-inch thin crust take-and-bake pizzas cost $5.99.

"We're really driving those price points out there to let people know we have that quality and value," Servais says.

At Whitehouse Station, N.J.-based Quick Chek, senior vice president Mike Murphy says that his company's willingness to work with the consumer during the most difficult economic times will tip the retail scales in his direction over the course of the coming year.

"The customer has really been tight with their money for the last year. And with them having a few more dollars in their pocket right now, they're going to splurge a little bit," he says. "If they can feel good about buying something different in a place that appreciates them … I think it's going to help us continue to grow."

It is because of this consumer-centric philosophy that Quick Chek, which has more than 100 stores, isn't spending money to take its foodservice program in another direction; it is investing in its employees. Murphy believes that if you take care of your employees, they'll take better care of the customers. So Quick Chek is putting its foodservice team through the same management and development program it put its management team through. He's hoping that by upping the level of consistency in that department, the customer will notice the employees' dedication to service and keep coming back.

"With everything that's going on economically, people are really stressed," he says. "Whether it impacts them directly or not, they are stressed over it. If you have the right people, I think you can keep that customer."

At Dash In Food Stores, La Plata, Md., it's all about the promotion. While the 33-store retailer tries to stay ahead of the innovation curve by stocking new products, constantly meeting with brokers and salespeople showing new things, it is finding that bundling its food offerings with a full package is offering added value for customers and paying off for the company as well.

For example, according to Larry Bullis, merchandise marketing manager, Dash In was offering a 4-ounce chicken patty on a potato roll for $2.99. "We were selling about four chicken sandwiches a day," he says. "And then, if we had one or two write-offs during a day, we weren't making a lot of money on an item like that."

Bullis went back to the manufacturer for promotional support. "We're trying to gain customer accounts back into our stores by balancing the average transaction," he says. "You can't just raise prices and expect to get your retail up on an average transaction. You're going to have to balance value propositions."

The result? "We grew that item to 30 sandwiches per store per day," Bullis says. "When you go from four at $2.99 with some write-offs, and you go to two for $4 and you're selling 30, even though the gross profit percent is a little less on that second one, you're satisfying the customer. We built the business on that one item and we've been able to sustain that even to this day."

TERRIFIC TWOS: Dash In Food Stores' "Seeing Double" campaign hit on items in the store that customers shop for on a day-to-day basis. Promotions such as these have helped the retailer capitalize on new foodservice customers.

Checking Out the Competition

With consumers now spending their food dollars more moderately, the competition will inevitably heat up between convenience stores and quick-service retail locations, and fast-food restaurants.

"Retailers should realize that in this environment, fast feeders are their competition," Dirks says. "In the past, a customer would get their gas, buy a $5.99 sub sandwich, chips and a drink. Now a customer knows Subway has a $5 footlong and will take the extra time to go to Subway to save the money."

Understand the fast-food retailers and their strengths, suggests Technomic's Paul: "In all actuality, the fast-food restaurants are not being hurt like the rest of the restaurant industry." If c-stores can understand why their competition is proving so resilient, they can draw some of the clientele their way.

The only fast-food sphere hurting is pizza because of competition from grocery stores and refrigerated pizzas, according to Paul. He says this is evident in the big pizza chains that offer sandwiches and pasta. "There surely is an opportunity for pizza programs in c-stores as well," he says.

Kwik Trip is acutely aware of what it's up against. "The biggest thing we've noticed is that everything is very, very value-driven. Right now, if you turn on the TV, all you see is McDonald's and Dairy Queen pushing their dollar menu, or $2.22 menu. That's really all you hear. And we're really doing the same thing," Servais says. "We're running even with last year; we aren't down, but we're not growing like we have in the past. But we're still seeing gains in our sales dollars and we're holding our own very, very well." ■