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An appetite for change

Key trends driving innovation in the restaurant industry

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A rapidly changing industry

All-day breakfast at your local drive-through. Blue Apron redefining home delivery. Eatsa creating a futuristic "Jetsons"-like restaurant experience. Real-time GPS tracking of delivery to your door from your favorite high-end restaurants offered by Caviar.

There is no question restaurants are innovating—but are they moving fast enough to stay relevant in the face of evolving consumers' tastes and preferences? This is a particular challenge for established companies where risks are magnified—there are enormous profits, thousands of jobs, and publicly traded share prices on the line.
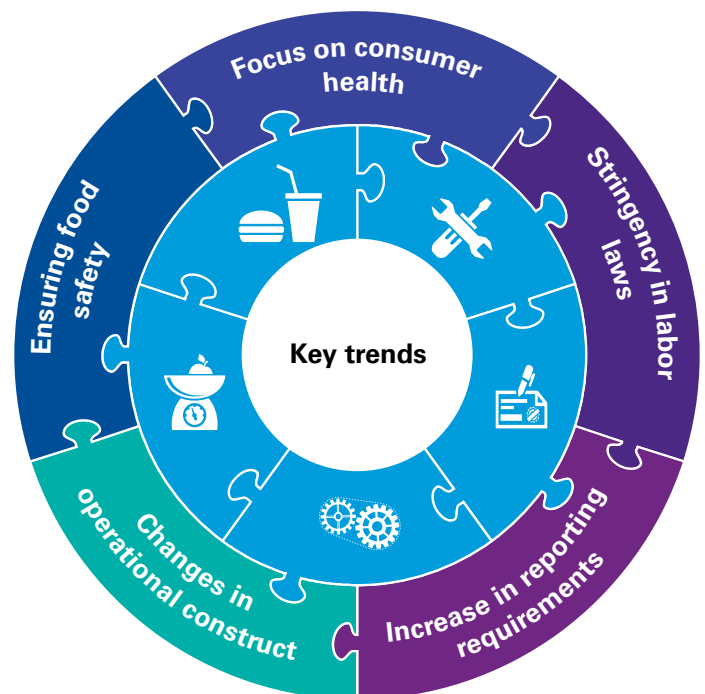
Like many industries, the restaurant industry faces a variety of challenges keeping up with the rapid pace of change driven by the consumer trends and changing demographics. Growing preferences for healthier food options, concerns over environmental sustainability, increased competition from grocery stores, heightened consumer expectations, and rapidly advancing technology are reinventing the traditional dining experience and forcing change on how the industry operates. And the rising spending power of the millennial generation of consumers is accelerating the industry's response to such trends.

At the same time, economic forces continue to have an industry impact. GDP growth is slowing while the average household income is decreasing, leaving consumers with less to spend. In fact, rising healthcare and education costs have reduced spending on food by an average of $347 per household. Food accounts for nearly 30 percent of a restaurant's costs, and unfavorable weather and macroeconomic conditions can result in a substantial increase in food prices. However, fear over weakening their market position often prevents restaurant operators from increasing their menu prices in the same proportion.

Against this backdrop, most economists agree that this new normal environment is not one where secular growth can satisfy most company growth needs.

As restaurants juggle a variety of challenges, they must seek to innovate and adapt nimble business strategies that enable them to cost-effectively compete in an ever-changing tech environment. Yet, as they rethink business approaches, they must also factor in new regulation as well as economic and competitive market forces. No industry is immune to these forces. But to remain competitive and succeed, restaurants must be able to adjust and figure out how to meet and exceed consumer expectations.

That does not necessarily mean being the first to innovate in your market. There are benefits in being a fast follower. In fact, many restaurateurs may have better results as a fast follower.


Key trends: Focus on consumer health, Stringency in labor laws, Increase in reporting requirements, Changes in operational construct, Ensuring food safety

The need to innovate

The threat

The "crowding out effect" of rising healthcare and education costs has reduced spending on food by an average of $347 per household.
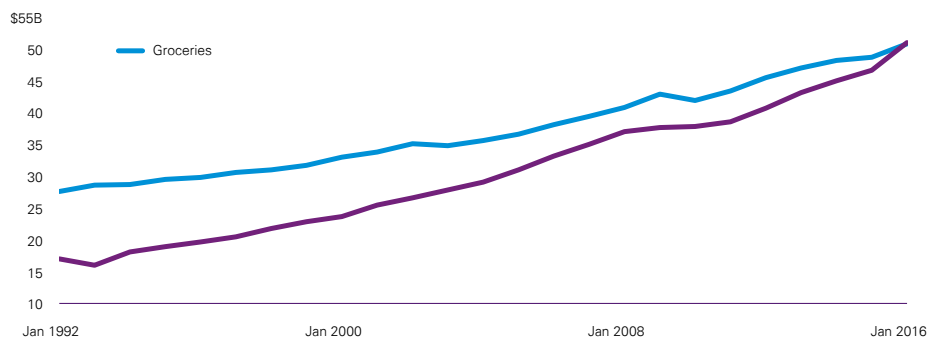
Mean household expenditure change 2000–2013 (2015 dollars)
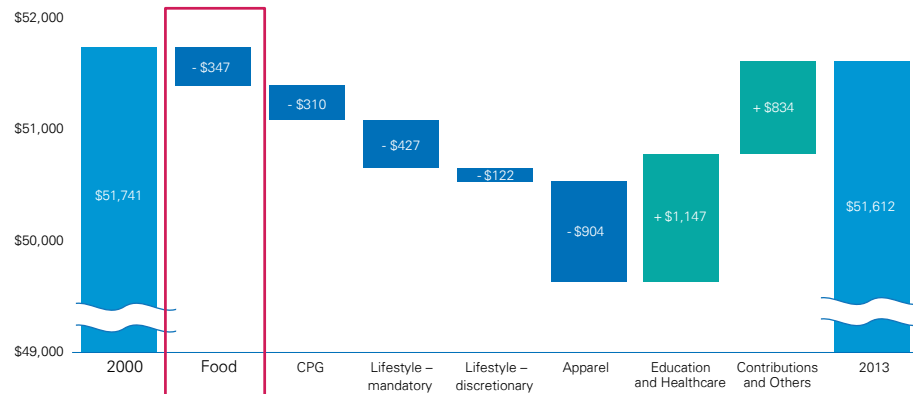
The opportunity

Dining out growing at expense of eating in

Consumer spending

Source: Bloomberg Markets, "Americans' Spending on Dining Out Just Overtook Grocery Sales for the First Time Ever," April 14, 2015, http://www.bloomberg.com/news/articles/2015-04-14/americans-spending-on-dining-out-just-overtook-grocery-sales-for-the-first-time-ever

"The challenge in a disruptive world is to be courageous. This is easier for small companies. It's harder to do when the numbers are very big, and the risks are very big."

—CEO of brand name restaurant chain

Restaurant industry trends

Seven trends that should be at the heart of an innovation strategy.

Preferences for healthier food options
— Consumers prefer to eat at home and, if dining out, are inclined to consume healthier and less processed foods.

— Restaurants have been making attempts to influence consumption patterns by deploying attractive pricing and marketing techniques.

Modification of menu items driven by regulatory norms
— With nutrition labeling requirements being enforced by the Affordable Care Act, restaurant operators are obligated to make changes to menus to show the calorie counts of their products.

— Restaurant chains are focusing on narrower and more specialized menus— with an objective to enhance quality standards, speed, and service.

Increase in food service options
— Restaurants have been losing market share to supermarkets, which have started stocking wide ranges of ready-to-eat meals; further, an increasing number of them have added eat-in areas.

— Additionally, an increase in the number of players offering similar products clustered in the same location is leading to saturation—resulting in fewer unique consumers per outlet.

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Technological advancements
— Restaurant chains are adopting new technologies for ordering, payment, and loyalty programs to offer convenient and intuitive applications for customers.

— Analysts foresee creative uses for Google Glass, such as glass-wearing servers using face recognition technology to quickly locate patrons in crowded bars. Data from Apple Pay and other electronic wallet solutions will also make it easier to personalize customer experience.

Environment sustainability
— Restaurants have been focusing on reducing food waste to manage rising costs and to "go green".

— Rising awareness of sustainability, especially among millennials, is forcing restaurants to implement environment-friendly and sustainable practices.

Inclination towards global cuisines
— Increase in preferences for global/ethnic cuisines is prompting restaurants to diversify their businesses.

— According to a survey by the NRA, 80 percent of consumers eat at least one ethnic cuisine per month.

Focus on Generation Z
— Restaurants are currently trying to appeal to millennials and are competing for the attention of this social media savvy generation. They also need to be mindful of Generation Z as younger teens are beginning to make their own decisions about where to eat and what to eat.

— This demographic would also demand high-tech service, louder music, moving visuals to get heightened experiences. Restaurants will have to adapt and modify their operating strategy to attract this target segment.

The opportunity: Understanding the new consumer mind-set

It started with millennials but it is not just about them. The millennial generation has changed and impacted the entire span of the whole consumer mind-set, regardless of demographic. Consumers are constantly connected and have high expectations regarding quality, sustainability, and convenience.

This cultural mind-set has a greater value on "experience" and "convenience." These empowered consumers shop anytime and anywhere, meaning that companies must get products to consumers where and when they want them in order to stay relevant.

Consumers continue to raise the bar for what is considered "fast" and "convenient," and restaurants and food delivery companies are reacting with enhanced business operating models to create customized, technology-enabled experiences.

With the rapid adoption of even more connected mobile devices across multigenerations, consumer expectations on their path to purchase are evolving quickly into a complex, multifaceted process. For example, today, there are over 64 different paths to purchase versus just 1 in the past 10 years.[1] Social sharing has a large impact on decisions and peer-to-peer reviews carry a lot of weight.

All consumer-focused companies must understand and react to this power shift. Restaurant operators are emphasizing the quality of service while increasing the direct interaction with customers. Restaurant chains, especially fine and casual dining, are also attempting to increase foot traffic by expanding their social media presence.

Meanwhile, brand and food expectations are also changing. Convenience and health are important, and people want to know where products are coming from. Consumers do not trust traditional media but instead look to reviews before purchasing. In addition, the barrier to enter the market is lower than ever. This presents a challenge for established brands. Small companies are now taking market share, and big brands are not guaranteed to dominate in the same way anymore.

Therefore, with all the myriad challenges facing the industry—changing demographics , advancing technology risks and opportunities, increasing regulations—restaurant companies need to keep a primary focus on innovation. Whether that means being a "first mover" or a "fast follower" in the marketplace is less important than being agile and ready to move fast. It means being aware of the weak signals in the marketplace and having a framework for innovation embedded in your organization in order to be in a position to move when the time is right.

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[1] http://www.business2community.com/marketing/first-step-road-becoming-multi-channel-marketing-expert-01177942

The result is that food expectations are changing

Media plays an important part in American food culture. From movies such as *Super Size Me* to reality shows such as *The Biggest Loser*, weight loss (and how people are losing weight) are at the forefront of American culture.

84%
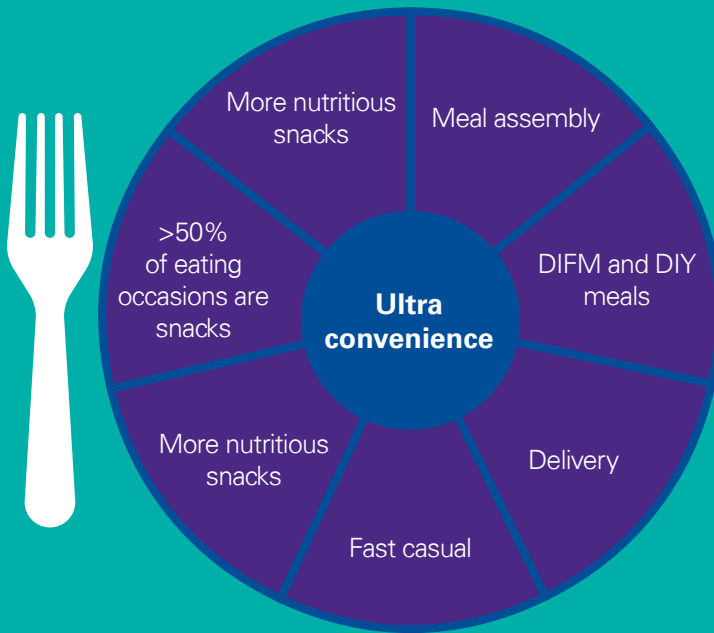of millennials do not trust traditional advertising
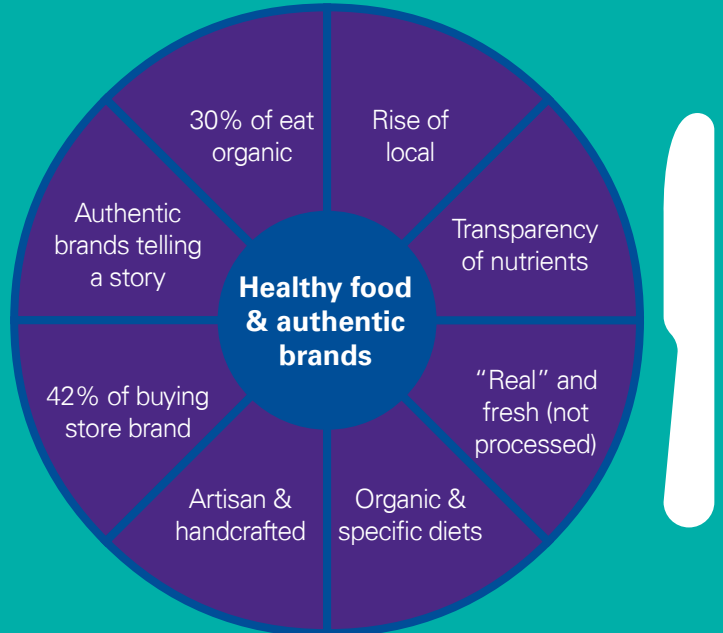
73%
of Americans trust food blogs

56%
of Americans have purchased a product from the recommendation of a food blogger

Our expectations of food have changed.

More nutritious snacks

Meal assembly

>50% of eating occasions are snacks

Ultra convenience

DIFM and DIY meals

More nutritious snacks

Delivery

Fast casual

Our expectations of brands have changed.

30% of eat organic

Rise of local

Authentic brands telling a story

Healthy food & authentic brands

Transparency of nutrients

42% of buying store brand

"Real" and fresh (not processed)

Artisan & handcrafted

Organic & specific diets

Quick, healthy, authentic, and reviewed or suggested

Source: BlogHer Survey and McCarthy Group, 2014

Innovation in the industry

Consumer trends by the numbers

64% – Consumers who are more adventurous in their restaurant food choices than they were two years ago

69% – Consumers who are more likely to visit a restaurant that offers locally produced food items

60% – Consumers who are likely to choose a restaurant that offers items grown or raised in an eco-friendly way

76% – Consumers who are more likely to visit a restaurant that offers healthful options

79% – Consumers who say restaurant technology increases convenience

70% – Smartphone users who view restaurant menus on their phones at least a few times per year

32% – Smartphone users who are willing to use an app to pay for meals instead of using cash or cards

Source: National Restaurant Association, 2015

In response to the decreasing food dollar and the empowered customer, restaurants are turning to innovative business and operating models to grab a greater share of the market.

In fact, more venture capital and tech company money is going to food business than any other industry except for healthcare. Most notably, competition for the consumer food dollar is not just from the traditional restaurant industry but is coming from new types of chains and delivery services.

Because the paths to growth are limited, restaurants are looking for growth through increased market penetration, innovative product development, new markets, diversified businesses, and new business models. For example, restaurants are redefining what is "fast" and "convenient" by offering fast-growing fast food chains, "do it yourself" (DIY) food delivery, and "do it for me" (DIFM) food delivery.

Fast-growing fast food chains: Fast-growing fast food chains are pursuing innovative ideas over the food concept, the restaurant experience, and technology enablement. Chains are focusing on healthy food or changing the concept of fast food in new ways that is prepared fresh using natural, high-quality, locally sourced ingredients. They are also changing the restaurant experience and pursuing the "fast casual" concept that uses the line model and has transparent and customized food preparation, hip dining areas, and alcohol products.

DIY food delivery: Companies are innovating on "convenience" as there are emerging concepts in subscriptions for food boxes that provide everything needed to prepare a healthy, high-quality, home-prepared meal. This includes everything from meal replacement shakes to high-end recipes and focuses on healthy options that are sustainable and local and that also eliminate food waste.

DIFM food delivery: The concept of "fast" is also changing, as DIFM food delivery services emphasize easy and fast service that is local, provides specific subgroups of restaurant tastes, and comes from a curated restaurant list.

These services focus on niche value propositions such as extra quick delivery of everything, specialty meals delivery, free delivery, and real-time tracking. These options just scratch the surface of what is possible for offering quick, convenient, and appetizing options that can keep up with the new consumer demand.

More venture capital and tech company money is going to the food business than any other industry except healthcare.

A recipe for the future

In our work with successful innovators across many industries, we have seen two common factors in driving successful innovation. The first step is in reducing the obstacles that typically crimp attempts to innovate. The second is to employ a simple three-step framework to drive innovation efforts.

We believe the approach requires two essential and related steps: facing the obstacles to change and aligning the organization for fast-paced innovation. The power of an approach lies in the details.

— **Step 1: Facing the obstacles**

Many in the restaurant sector recognize the multiple challenges facing their industry but have not yet fully come to terms with their effect on the ability to innovate. They understand completely that fast-paced innovation can be disruptive, and they understandably struggle to balance it with core businesses they must not change. And yet there are other cultural and institutional obstacles—many of them core strengths in the past—that impede innovation in the current ecosystem:

– *Reward failure*

Innovation is high-risk and requires failure—something that true innovators expect and celebrate—but industry tends to reward well-executed, low-risk change.

– *Invest in risk*

Innovation means making financial commitments according to compelling investment theses. This marks a difference from traditional industry approaches, which make business decisions based on carefully calculated ROI. For example, as a business decision, a concept like Uber would be turned aside.

– *Think disruptively*

The traditional industry often finds it difficult to embrace truly powerful innovation, refusing to examine it where the industry has been most successful. That is different from the courage Apple showed to intentionally disrupt the iPod with the iPhone, producing a phenomenal result.

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- *Partner to innovate*
  Many industries instinctively prefer to build from within, cutting themselves off from the ideas of outsiders and the dynamism partnerships bring.

- *Secure new talent*
  Many industries face a war on young talent at the same time their knowledge base is shrinking as older talent retires.

- *Build global awareness of innovation*
  Industries need to capitalize on innovation anywhere, which means it needs better awareness of new centers of innovation everywhere from Tel Aviv to Berlin and from New York to Silicon Valley.

— **Step 2: A framework for innovation**
There is a means of addressing these challenges and achieving faster-paced innovation. First, however, a simple truth: There is no single answer to innovating successfully, no one-size-fits-all solution. No expert—no business professor, successful entrepreneur, author, or consultant—offers a prescription that works for every company and every solution. The most successful innovators today take different approaches. And successful innovators from the past do not offer an enduring lesson for all circumstances and all companies.

Of course, we have seen and believe in patterns and common elements to some approaches, but successful innovation fits the individual company and its culture. It must be customized.

A tailored approach works like an innovation engine with a three-stage assembly line: sensing unmet needs of the consumer from a profound awareness of the ecosystem and a leverage of the proprietary insights of the company, intensively investigating potential innovations from these insights, and creating market-changing innovations that are appropriate to the culture of the company. Admittedly, it is a complex process, but the result can enable a company to institutionalize faster innovation paces.

With a new capacity of faster innovation in place, there is still a critical step that remains and must not be overlooked. The processes for faster innovation must connect with the larger organization of the company. They must be integrated with existing processes that connect the company with its customers and, in turn, can help satisfy their appetite for change.

There is no single answer to innovating successfully, no one-size-fits-all solution.

About the authors

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Paul is an Audit partner and has over 23 years of experience with the firm. He is the managing partner of the Louisville office and the National Restaurant segment leader for the firm. He is also an SEC reviewing partner—KPMG's designation for its top technical partners.

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Joel leads KPMG Consumer Markets Strategy group and has over 15 years of experience in strategy and operations consulting, focused in the retail and consumer sectors. He specializes in value creation for retailers, ranging from broad-scale turnarounds to engagements on specific topics such as corporate strategy, assortment, pricing, promotions, format innovation, and supplier negotiations. He has led major engagements with retail clients in North America, the United Kingdom, and continental Europe.

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Dan is a principal in KPMG Strategy with more than 25 years of experience working in a variety of industries including consumer markets, retail, diversified industrials, media, healthcare, and financial services. Dan specializes in the development of business and operating model strategy, target operating model design, and large transformation projects.

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About KPMG

KPMG International and its network of member firms (collectively "KPMG") are a global network of professional firms providing Audit, Tax, and Advisory services operating in 155 countries and employing more than 174,000 people. Our U.S. member firm, known as KPMG LLP, traces its origins all the way back to 1897 and became a limited liability partnership in 1994. As a leading professional services firm, KPMG LLP has more than 30,000 partners and professionals providing services throughout all 50 states. With 90 offices, we are a significant presence in your current markets and in those locations where you may want to expand.

Our high-performance culture promotes using our experience and insight to simplify complex challenges, seek new opportunities, and deliver informed perspectives and clear methodologies of value to clients and stakeholders. Our client focus, commitment to excellence, global mind-set, and consistent delivery build trusted relationships that are at the core of our business and reputation.

KPMG is one of the leading professional service providers to the largest restaurant companies. This experience, coupled with our access to and knowledge of all major international markets, strongly positions us to assist our clients in recognizing opportunities and taking actions in response to industry, marketplace, and regulatory changes.

The KPMG Innovation Lab focuses on sensing and understanding signals of change through a people-first lens. Leveraging design thinking and outside-in perspective, we help identify how these signals may impact the growth and relevance of organizations based on our decades of research and knowledge in neuroscience and human creativity, as well as leadership in technology innovation, trends analysis, and start-up scanning.

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