An Economist's View of the Catering Sector

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Introduction

The objective of this paper is to set in context the material in the pages which follow. It therefore aims to expose a range of issues in an accessible way, whilst remaining loyal to the implicit assertion in the title that the subject matter will be approached from the point of view of a food economist, rather than that of a catering practitioner or policy maker.

The economist's view is exposed by means of the diagrams which follow. They can be found in any elementary economics text such as Lipsey (1990). These diagrams serve to illustrate to the reader a series of simple economic concepts, and together with the accompanying discussions address the economic issues which seem to underpin the catering industry.

There are inevitably omissions, due to the fact that the subject is approached in this way, but the intention is to raise the points and to allow the papers which follow to address them in more empirical detail.

The topic is tackled in five sections; the first considers general economic issues concerning services, followed by consideration of catering economics under four headings: The Market Demand for Catering Services; The Market Supply of Catering Services; Other Supply Issues; and Consumer Behaviour.

General Issues

According to Akehurst (1987), the economics profession has been relatively slow to take up the challenge posed by the emergence of highly service-based economies in the developed world, despite the contribution of service sectors to employment and income creation in these economies. This paper attempts to take one of the service sectors, catering, and examine the economic issues which underlie it.

Gadrey (1987) illustrates empirically that there is a relationship between the demand for services in an economy and the level of economic development of that economy. His examples, from France and the United States, indicate that the gap between 'service consumption', and the consumption of other goods (disaggregated into foodstuffs, semi-durables (e.g. crockery, textiles, leather goods, tyres etc.), non-durables and non-foodstuffs (other goods), has been steadily growing, and that therefore the service sector in these countries has been assuming an increased economic importance. The catering sector is no exception in this regard, and indeed the MarketPower paper which follows presents a statistical view of the number of catering outlets, large and small, which constitute a major sector of the national economy.

In this way then, macroeconomic developments and changes play an important part in the growth of a service economy, however overall statistical conventions concerning the national accounts obscure some of the changes within parts of the economy which impact more directly on the various services sectors.

This macroeconomic viewpoint, and the importance of the sector in national economic terms, is taken up by the Ministry of Agriculture, Fisheries and Food (MAFF) paper. This paper considers the various social and economic developments which have played an important part in shaping changes in the catering sector, especially with respect to demographic trends such as the increase in female participation in the labour force, generally later ages at marriage, and other factors which have led to smaller sized households. The combination of these changes have increased demand and encouraged the expansion of the number and range of catering businesses. Ally this to increases in household disposable incomes, and the proliferation of businesses in the catering sector becomes inevitable.

It should perhaps be noted that there are some paradoxes, however, in the economic consideration of this sector, which are highlighted in the paragraphs that follow.

Gershuny (in three books (Gershuny 1978, 1983, and Gershuny and Miles 1983)), outlines the argument for the proliferation of services outlined above. This argument suggests that as incomes rise, households will demand an ever-increasing range of luxurious consumer services (and service 'functions'). However, this increase in household income means that its marginal utility declines - that is, the more that is earned, the lower the value placed on the next increment in income. In this way the opportunity cost of work increases, and people demand more leisure time. At the same time, the increasing productivity in the production of consumer goods means their real costs decline, and consumers consider replacing the services provided by others with these (now cheaper) goods and services. The paradox then, is that as incomes rise, and consumers are put in a position where they can afford to purchase (catering) services - rather than 'doing it themselves', it may be that the increase in leisure time will encourage them in the opposite direction. They will still demand the service functions, but will supply them with a range of goods and their own labour. Figure 1 attempts to put this argument in perspective.

The growth in catering establishments and eating away from the home therefore suggests that the social pressures of demographic and occupational change actually outweigh the economic premises outlined above. The following sections address the issues in more detail.

The Demand for Catering Services

An overall picture of the catering market is impossible to represent in a single diagram, because the range of businesses are offering non-homogeneous products, and this makes it illogical to compare between those parts of the business offering high-class restaurant facilities with those offering a fast-food service. However, it should be borne in mind that the shape of the demand for the services will have a fundamental impact on the quantities of that service required, and therefore the potential for new suppliers to enter the industry. It will also have an important impact on the prices that will prevail in the sector - and therefore the profitabilities of the businesses involved.

This is an important argument because, although the overall demand for food volume is bound to be relatively static (given limited population growth), food provided in a processed or catered form is a different (added value/luxury) product, and certainly in times of economic hardship the return to more basic, home-cooked foods with less services attached is likely.

Figure 2 considers firms in several catering submarkets. Part (a) illustrates the potential

Figure 1. THE EFFECTS OF INCREASED DISPOSABLE INCOME ON DEMAND

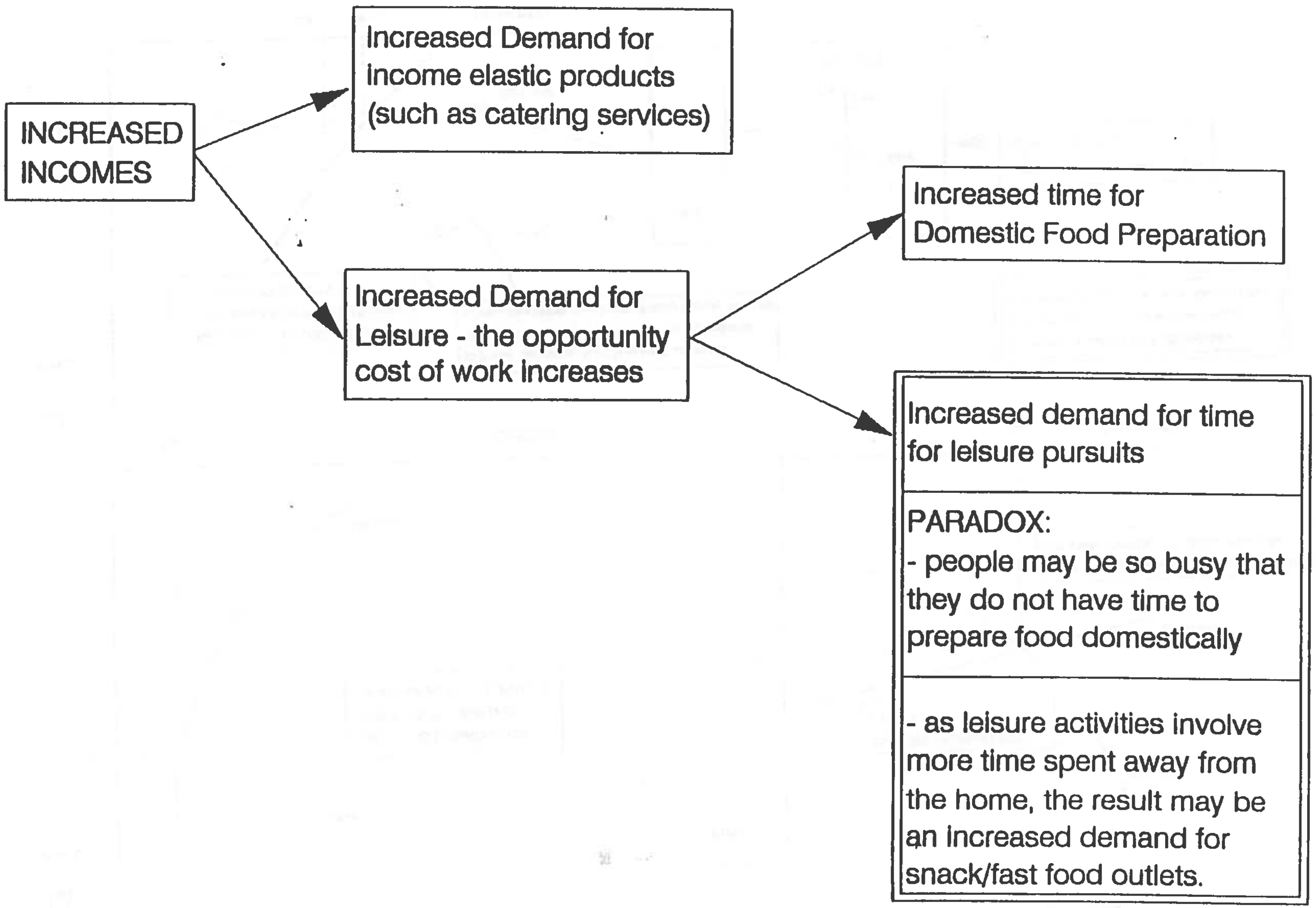
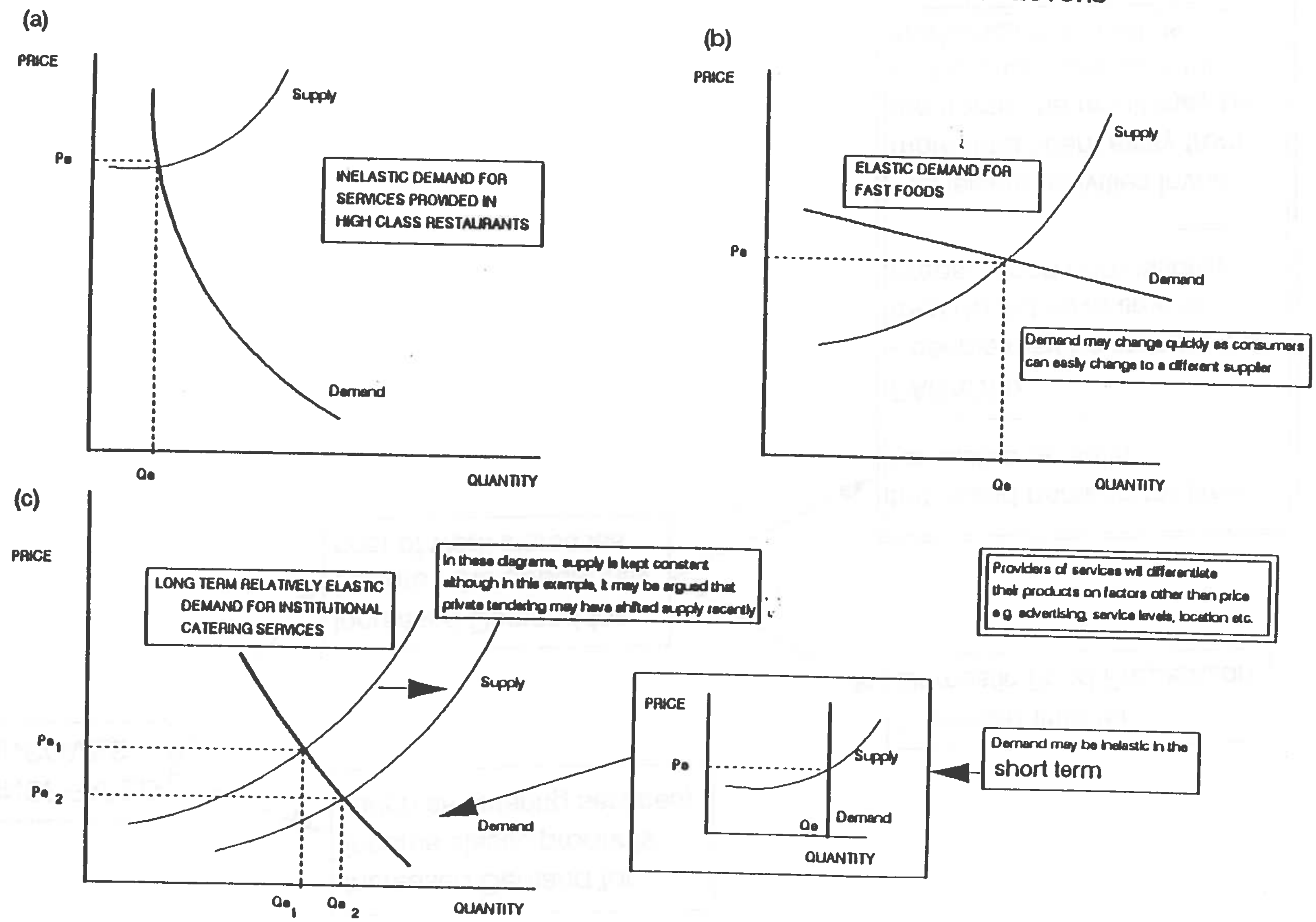


Figure 2. DEMAND CHARACTERISTICS FOR FIRMS IN DIFFERENT SECTORS



demand position for high class restaurants. Its prices would be determined by costs of production but also by a margin reflecting what the market might be expected to bear. It might be assumed that, as far as prices were concerned, the reasons why people eat in high class restaurants, which may range from the fact that their income enables them to do so habitually, to the fact that they have gone there for a special occasion, will outweigh any small changes in price that such outlets may choose to implement. Income changes and recession might be expected to be the demand shifting features of this subsector.

In this sector it is likely that substitution between the products of firms in different sectors of the overall market for catering will be the major influence on the response of demands in the various sectors. The response will therefore depend on the availability of such substitutes - for example in a local area, there may be relatively few substitutes for the one high-class restaurant, and so if it were to increase its prices, its demand may not suffer unduly - it is operating a local monopoly. Conversely, if a High Street fish and chip shop in a large town increased prices, its customers could move relatively easily to a rival outlet.

Figure 2(b) speculates on what might be the position for fast-food restaurants. Demand may be expected to change quickly, because consumers can easily change supplier, and may not necessarily remain brand loyal. Thus the demand curve is shown as being relatively flatter (more elastic), and indicates the need for these establishments to remain price competitive, to advertise, to innovate, or to improve their levels of service provision. (Delattre and Oriach (1985)).

The MarketPower and ASDA papers also address the question of the potential demand shifting due to changes in the prices of competing products. Substitutes in this case may be other catering market segments (i.e. individual market segments are interdependent, and changes in price of products in the fast food sector may influence, for example the demand for school meals), or the price of ready meals from retailers - which may be seen as competitors to take-away outlets.

The two diagrams in figure 2(c) suggest that in the short term demand for services in a school or hospital may not alter at all as there must be a significant time delay in switching suppliers - and therefore no other options for the consumers of the service. In the longer term demand will be a little more elastic, although the lack of substitutes for many institutional catering situations (prisons, hospitals etc.) might suggest that demand response to price change will always be limited. Recent trends towards private tendering may have led to increased competition and a rightward shift in the supply curve, tending to drive prices downwards (as inferred in Mr. Forte's paper).

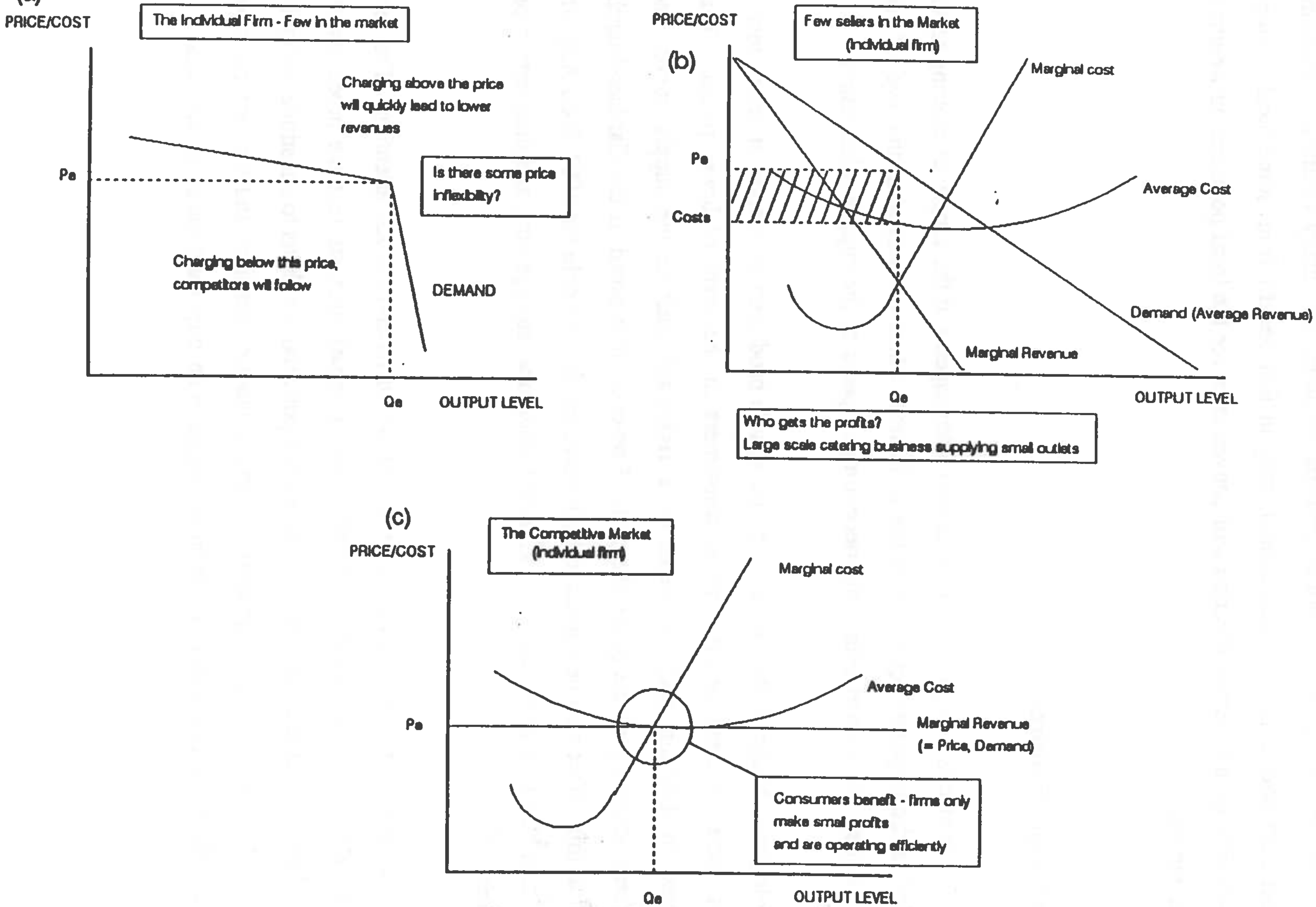
The Supply of Catering Services at the Market Level

This section raises a number of issues with respect to the provision of services by the firms in the catering industry - the Marketpower paper puts the issues in sharper relief.

Figure 3(a) illustrates the common position in markets where there are only a relatively few producers - there may be a price level which becomes relatively stable or inflexible. This occurs because a firm is unlikely to gain by dropping its own price (competitors will immediately follow), nor by charging a higher price (they will then lose out to competitors who remain at the previous price level). This situation occurs in markets where the product offer is relatively similar from all firms - it may, for example, be the case in the fast food/burger industry, where other forms of non-price competition predominate. The Marketpower paper points out that the concentration of power in the retail sector, for one, may cause distortions in the market for the inputs to certain catering businesses.

Figure 3(b) suggests that some firms may have a monopoly in the market - they are the sole supplier of the product (or their product is sufficiently different from the competition that it can be regarded as unique), and therefore may charge the price that the market will bear, without regard to the underlying costs of the operation. In this way a top restaurant can operate above its average cost curve, and take supernormal profits, because it is offering (in addition to the basic food provision) standards of comfort, ambience, service (and perhaps the reputation and skills of its chef) that offer consumers sufficient utility for them to wish to pay relatively higher prices. Figure 3(c) illustrates the opposite position, where firms are competitive and are forced by competitive pressures over time to operate at minimum cost.

Figure 3. THE SUPPLY OF CATERING SERVICES



In the longer term, such competitive pressures (especially the impact of the entry of new firms into the industry) are likely to result in further trimming of costs and the adoption of cost-saving technologies. It should perhaps be noted that many catering establishments, whether institutional or non-institutional, may in fact benefit from some local monopoly - they are simply in a certain location and convenience for the local populace outweighs other considerations.

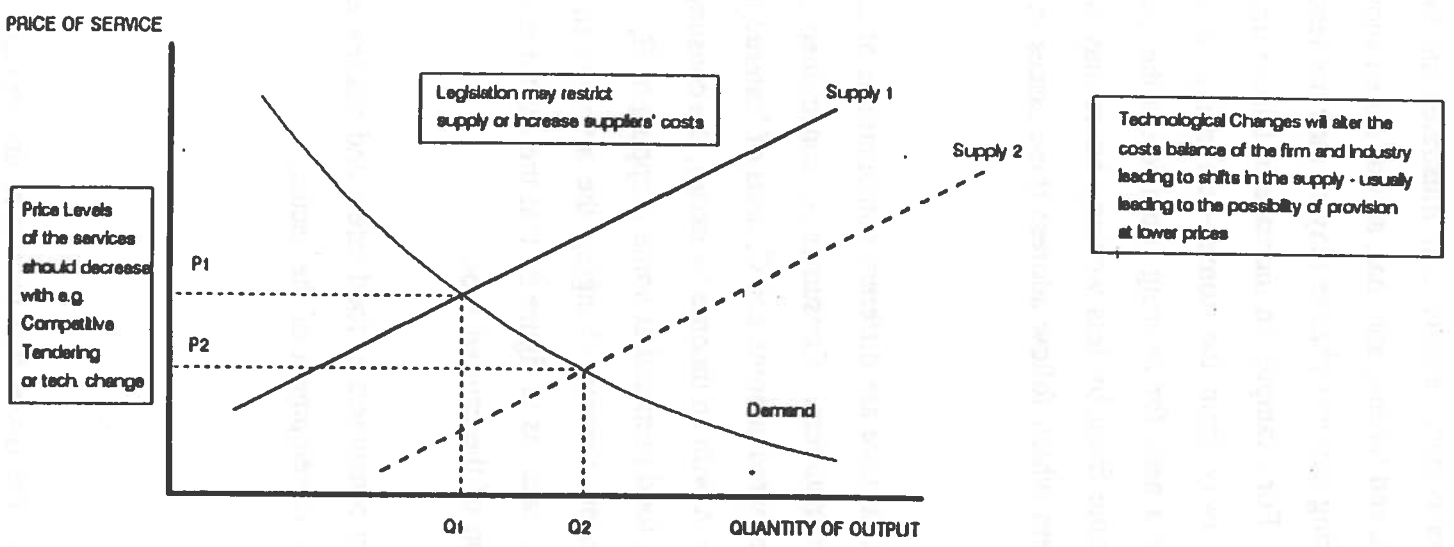
Other Supply Features

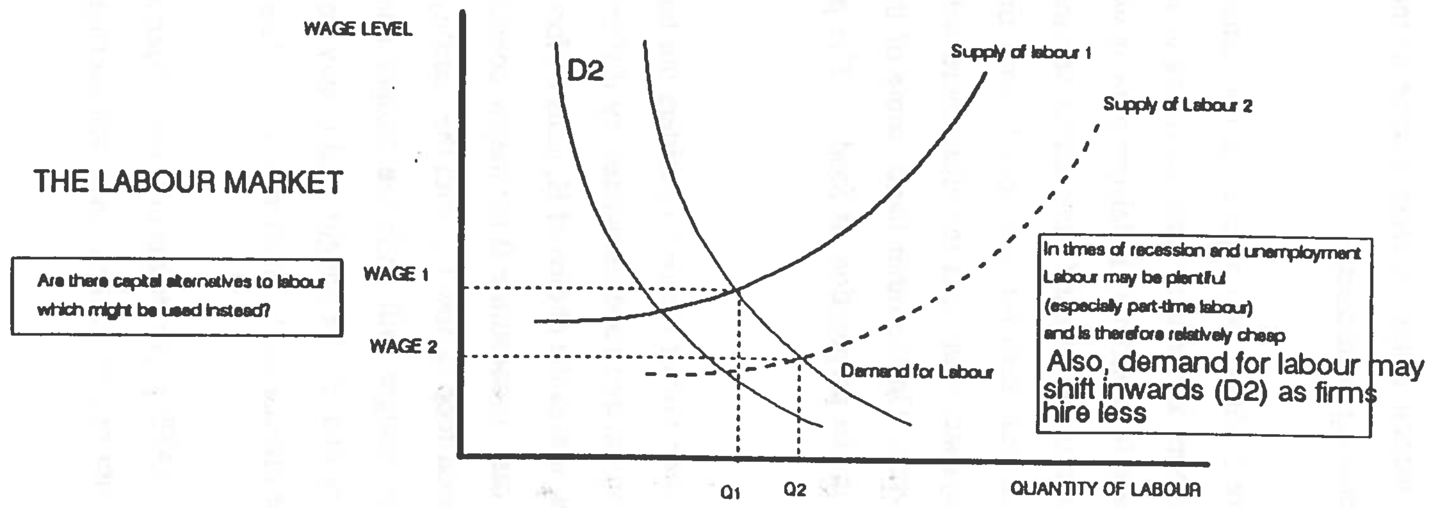
The purpose of this section is to examine two other aspects of the supply of catering services. The first is the important question of the influences which actually alter the level of supply in the market, the second being microeconomic aspects of the supply relationship.

Technological change in the industry should enable producers to operate at lower cost, and to pass some of these benefits on to consumers in the form of lower prices. This is illustrated in diagram 4(a) by means of a rightward shift in the supply curve, and a consequent lowering of the price charged. However, it is noted in the Gardner-Merchant paper that this effect may be restricted by legislation (for example the 1991 Food Act) which may in turn lead to higher costs of food safety assurance, storage etc., and thus restrict price decreases.

The labour market in the catering sector is one which receives much attention. The sector is a large employer, but Gershuny (1983) (for example) suggests that the productivity of labour is low. In certain parts of the market, the potential for firms to substitute technology for labour is quite high, but in general catering is labour intensive, and workers are poorly paid. Legislation with respect to minimum wages is an important factor in this area.

Figure 4. OTHER FEATURES OF SUPPLY





Consumer Behaviour

This section simply expresses some of the aspects of consumer behaviour which impact on the catering industries.

Figure 5 shows two aspects of consumer behaviour. Figure 5(a) illustrates the fact that consumers divide their time according to work and leisure, and that, as was stated above, the increase (or decrease) in leisure time as working patterns change may or may not lead to an increase in the demand for catering services. For example, an increase in leisure time may suggest that families will spend more time away from the home - travelling, days out, holidays etc. - and that therefore there will be a need for catering provision at the locations they visit. On the other hand, some of the time freed by less working hours may well be spent in the preparation of food. The papers which follow address these issues in more detail.

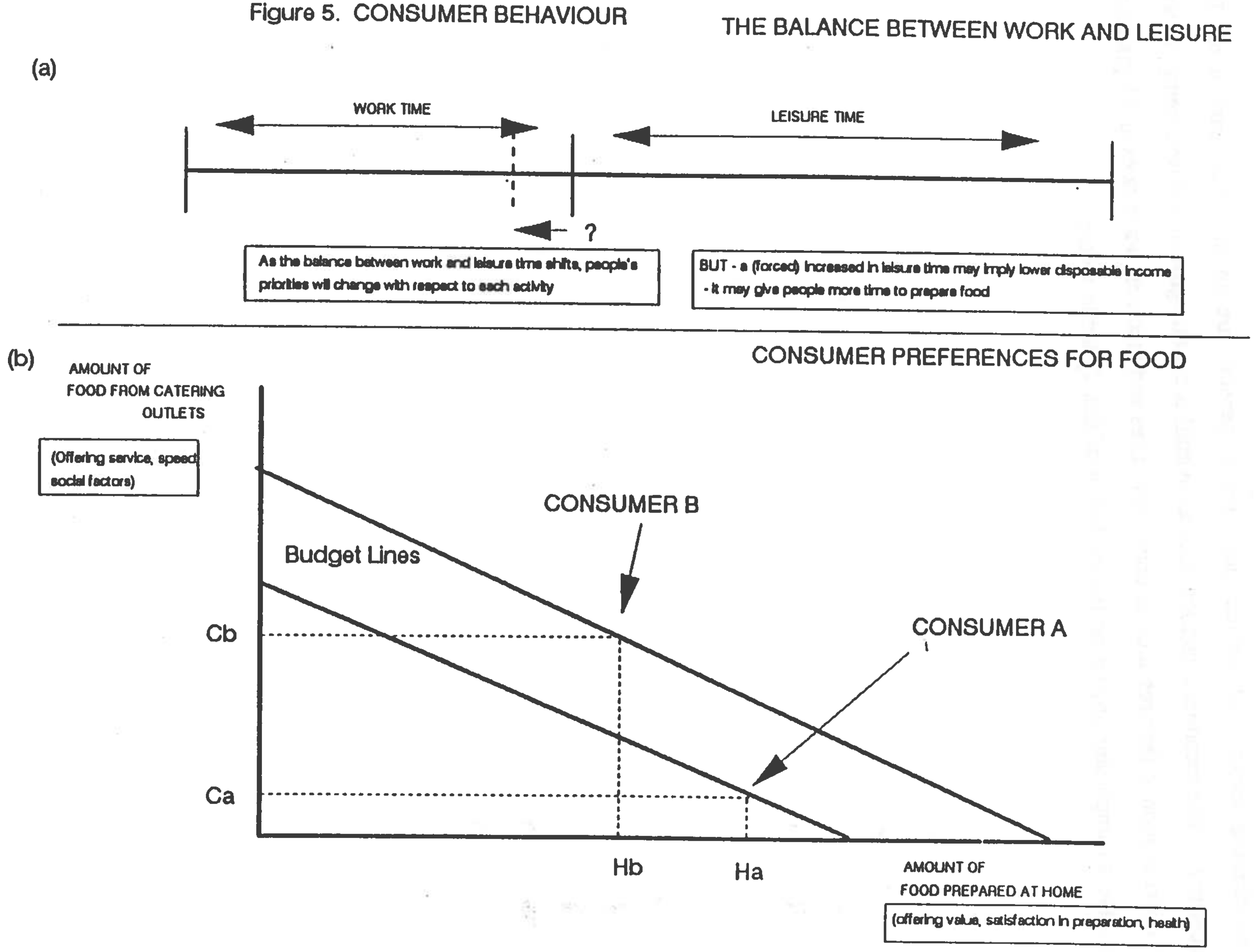
The lower part of figure 5 considers the fact that there are different combinations of catered and non-catered food demanded by different consumers. Consumer A, constrained by his budget, makes the choice of H_a units of food prepared at home and C_a units of 'catered food'. In the case of consumer B (or maybe consumer A with an income increase), the consumption of catered food is now C_b, with the quantity of food prepared at home dropping to H_b. Thus income changes will shift the budget constraint, thereby changing the amounts in each category that can be bought, and it may be the case (as in figure 5) that the shift due to the income effect may be primarily in the direction of the catered food.

As the MAFF paper points out, the influence on consumers of food safety and healthy eating should not be overlooked when considering the development of the sector.

Concluding Comments

This paper has set in economic context some of the issues that managers and practitioners in the catering industry need to address. It has deliberately not used real data, nor is it

Figure 5. CONSUMER BEHAVIOUR



exhaustive in its coverage. The papers which follow pick up on many of the ideas presented above and expand them.

The catering sector, and service industries in general, are an important part of the UK economy. Macroeconomic factors, such as overall economic growth and well-being, as well as microeconomic features such as consumer tastes and incomes, wage rates and legislation, all have an important impact on the evolution of this dynamic sector.

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