



The Institutes™
Proven Knowledge. Powerful Results.

According to the National Restaurant Association, the restaurant industry generates \$1.7 billion in sales on a typical day. That number is expected to increase during the month of February, as the association estimated 70 million people dined out on Valentine's Day this year.

So what does that mean from a restaurant's risk management perspective?

Restaurants must understand their strategy and what their strategy means to risks associated with it. They must also understand risks generally associated with restaurants. Restaurants face several types of risk: operational, strategic, and economic.

Operational risks are risks associated with the facility itself. Slips and falls are a common problem both for customers and employees. People who drink too much alcohol or minors who are served alcohol can present problems with the law, licensure, and lawsuits. Workers may injure backs, cut fingers, and drop hot liquids. Kitchens are the most common place where fires begin, and buildup of grease is a common cause of fires. Many operational risks associated with restaurants can be controlled or mitigated through sound risk management strategies such as rigorous cleanliness practices, employee education, protective devices, and sprinkler systems for cooking equipment.

Strategic risk is more complex. Strategic risks include management decisions regarding new products, emerging competition and planning issues. Risk to reputation can be associated with almost any peril or event. Recent outbreaks of food-borne illnesses have devastated food suppliers and restaurant chains even when confined to one location. While such outbreaks are devastating to single-location restaurants, they can ripple through an entire chain, causing loss of customer traffic. Even false reports on the Internet and other communication media can have a disastrous effect on a restaurant. Therefore, while proper cleanliness and employee education are critical, restaurants also need to develop plans to quickly and equitably address unexpected disruptions. Maintaining or regaining customer confidence requires careful planning and communication.

Reputation isn't associated just with incident risk. Restaurants that change their menu, chef, key service staff, pricing, or other processes face risks to their reputation. A restaurant strategically driven towards high ratings and resulting prestige might find its rating lowered when a chef leaves or makes menu changes. Addressing this strategic risk requires an understanding of the criteria for being in a particular rating category. Even if a restaurant enjoys high ratings, people's tastes change, and maintaining clientele requires dedicated attention to shifting customer needs. This focus can include assessing data about which items are ordered, customer surveys, and even informal reports from employees on customer satisfaction. Changing trends in the sale of vegetables, herbs, and meats in local marketplaces can also show taste changes.

The community in which a restaurant is located also can affect the restaurant's reputation. For example, if the restaurant is located in a resort community that is no longer fashionable or goes out of business, will people continue to visit the restaurant? The same problem exists in a mall when an anchor store leaves and the mall receives less traffic. Determining which stores or other businesses near the restaurant attract traffic is a strategic activity that requires careful due diligence. Is the resort or mall a going concern, or is it declining in reputation and business? How well do these feeder locations perform in difficult economic times? Are there lease or union

problems? Are the anchor stores consolidating in other cities, or are they for sale? Are there community demographic issues that might reflect changing tastes for the businesses that draw traffic to the restaurant?

Restaurant owners must also deal with strategic risks involving growth and expansion. Should they open a new restaurant even if store managers think it is a bad idea? Should they lower their prices to remain competitive even though operating costs are still high, or should they consider changing strategic direction to compete? Researching local economics, demographics, and changing customer tastes before making any strategic direction changes is as important as educating staff on cleanliness in the kitchen.

As the restaurant industry continues to grow, restaurants face increased competition. In an effort to attract new customers and maintain current customers, many establishments are offering additional services such as entertainment and catering. Theme restaurants featuring movie, sports, and music memorabilia have also gained popularity over the past few years. These changes in strategy can affect financial risk and risk to reputation. For example, a quiet restaurant that introduces entertainment will likely face a changing clientele. What prompted this change in strategy? Has this strategy been carefully aligned with a client profile that is realistic for the restaurant, its menu, its reputation, and its ability to attract the target customer?

Restaurants are also faced with general economic risks such as unemployment, inflation, and changing population demographics. When people lose their jobs or face economic uncertainty, they tend to dine out less frequently. Additionally, highway construction, natural disasters (even those that do not damage the restaurant's structure or ability to operate), and weather conditions can affect a restaurant's financial stability. In the restaurant industry, location is key. For example, if a restaurant is located in the Pocono Mountains ski country, but there is little snow that winter, fewer people will travel to the Poconos, thereby reducing the restaurant's business. If a restaurant has an outdoor environment, it is also at the mercy of the weather. Restaurant owners must be informed about international rules and boycotts if they depend on imported goods. The smallest changes in policies or pricing can affect a restaurant's access to certain products.

Social justice and environmental stewardship are becoming increasingly important in the restaurant industry. Consumers want to know where ingredients are coming from, and restaurants are being challenged to offer more healthful options. Environmentally conscious companies advertise their use of recycled products and other "green" practices that reduce their environmental impact.

The issue of positive risk also exists—the risk of doing things too well. Positive risk that creates a greater demand for product that can be supplied can encourage competition. Positive risk can also entice a restaurant owner to expand or consider new locations. Can the same combination of product, service, location, and quality be maintained with the proposed change so that reputation is preserved? Answering this question and understanding the reasons for the success can help the restaurant determine whether to maintain its existing strategy and plant or to expand or consider alternatives—if, for example, the increase in traffic is likely temporary.

Restaurant Risk Management Ketcham



Restaurant owners, like any other business owner, should align risk management practices with strategic goals. While some risks cannot be easily controlled or mitigated, understanding the restaurant's strategy and the risks associated with that strategy and restaurants in general can make the difference between success and failure.

Bon appétit!

Christopher Ketcham, PhD, CPCU, CRM, CIC, CFP[®], is senior director of knowledge resources for The Institutes in Malvern, Pennsylvania. The Institutes are the leader in delivering proven knowledge solutions that drive powerful business results for the risk management and property-casualty insurance industry. The material in this article is covered in the textbook for the Enterprise-Wide Risk Management (ERM) program, which is among The Institutes' numerous educational offerings. Dr. Ketcham has responsibility for all aspects of risk management education. He can be reached at ketcham@TheInstitutes.org.

© 2011 American Institute For Chartered Property Casualty Underwriters
www.TheInstitutes.org