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# Controlling Labor Costs in Restaurant Management: A Review of the Internal-Marketing Concept as a Method for Enhancing Operating Efficiency

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Controlling Labor Costs in Restaurant Management: A Review of the Internal-Marketing  
Concept as a Method for Enhancing Operating Efficiency

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A professional paper submitted in fulfillment of the requirements for the  
Master of Hospitality Administration Program  
William F. Harrah College of Hotel Administration

Graduate College  
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**Abstract**

Restaurants experience many challenges, including economic uncertainty, competition, demographic shifts in target markets, changes in employee work habits, and such financial considerations as maintaining adequate cash flow. Controlling costs in the restaurant business is essential to the success or failure of the establishment. In the hospitality industry, labor costs are very high; in fact, they amount to approximately 45% of operating costs. The goal of this review is to promote further research into identifying the specific criteria that govern the relationship between the use of labor resources and the goal of operating efficiency, mainly with a focus on internal marketing as a means by which to control labor costs. This study lays out the relevant literature for understanding sources of labor costs, particularly as they relate to the potential of internal marketing as a source of efficiency. It then appropriately offers recommendations for controlling labor costs in terms of the cost of labor itself (*i.e.*, human-resource management practices), those costs associated with disruptions in the service flow and sources of error or lack of motivation in service delivery (internal marketing), and costs that occur due to gaps between employee preparation and espoused strategy. It concludes with a discussion of implications.

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## Introduction of Topic

### Overview

#### *Challenges for the restaurant industry*

Restaurants experience many challenges, including economic uncertainty, competition, demographic shifts in target markets, changes in employee work habits, and such financial considerations as maintaining adequate cash flow. A business is only as successful as its ability to maintain a consistently positive bottom line. The strength of these companies to succeed depends on how well they can control costs and capitalize on additional revenue opportunities, while simultaneously seeing to their own survivability by preserving some kind of competitive uniqueness *vis-à-vis* both the competition in the same industry and economic substitutes.

Hourly staff turnover in the restaurant industry is often extremely high, ranging from 94% in “high-volume casual and fine dining” to 136% in “quick service” annually (Berta, 2006, p. 22). Continually hiring new staff to compensate for attrition therefore often constitutes a major overhead expense as well. Restaurant managers thus often need to expend considerable time recruiting new staff and then training them, which processes only raise human-resource (HR) expenses further.

The deleterious effect of short-term and therefore usually inexperienced employees on customer relations, service, and hence productivity can be considerable. Insofar as their intentions may be to abandon the company shortly, short-term employees may also display low organizational commitment, which can result in their wasting time (*e.g.*, cell phone activity and texting). Meanwhile, inexperience can result in greater incidences of error, leading to product breakage and product waste. Indirect costs from these sources of inefficiency can come in the

form of reduced customer loyalty, which in turn will have a direct negative effect on the overall efficiency and profitability of the operation.

### *Controlling financial costs*

Controlling costs in the restaurant business is essential to the success or failure of the establishment. As a part of cost control, benchmarking restaurant financial activity is paramount. Preparing financial statements and comparing operating statistics against industry benchmarks is critical for strategic viability. To support the consequent need for the use of standardized reporting criteria, restaurant accountants (who are often the line managers themselves) adopt Generally Accepted Accounting Principles (GAAP; *cf.* Horngren, Harrison, & Bamber, 2003). These criteria support both industry-based benchmarking and the management of taxation, the former being important for strategic insights, while the latter is critical for institutional survivability itself, given that only after-tax profits are ever available for reinvestment into the enterprise.

For the restaurant industry in particular, the Uniform System of Accounts for Restaurants (USAR) provides standardized methods of account organization and guidance for record keeping, such that all entities that adopt these optimal criteria can compare their statistics against industry norms (National Restaurant Association, 1996). Originally established by expert accountants in the restaurant industry itself and updated annually by the same expertise, the USAR system naturally conforms to GAAP criteria in its structure (Weygandt, Kieso, & Kimmel, 2008). Once a restaurant adopts USAR norms, it has the ability to compare its performance and cost ratios to similarly situated restaurants and thus benefit from accounting guidance to inform whether it should take corrective action in one or more operating areas or is otherwise maintaining the necessary strategic viability.

*Controlling labor costs*

In the hospitality industry, labor costs are very high; in fact, they amount to approximately 45% of operating costs (Wang & Wang, 2009, p. 54). Particularly in the restaurant segment of the hospitality industry, employees have a direct impact on many ancillary costs associated with both physical inventory and the variable cost of goods, due to food service employees' role in the broader range of the value chain. Insofar as high rates of labor turnover result in higher rates of error in managing the value chain, this error propensity magnifies the effect of labor costs on broader restaurant operations. The relationship between labor usage and operating efficiency, as it implicates labor costs, arguably pertains to every restaurant, regardless of size or style.

Front-office employees are the face of the company in the restaurant business. Regardless of how good the food happens to be or how well one can control supply costs, labor costs are a major reason for restaurants' frequent difficulty in managing costs. Recent history, in fact, has only exacerbated this difficulty, in view of the 41% increase in the minimum wage from 2007 to 2009. Specifically, as Aaronson, French, and MacDonald (2008) have demonstrated, increases in the minimum wage affect restaurants acutely. While employee loyalty remains important to the success of restaurant operations, this loyalty seems to have become more difficult to nurture, as both competitive pressures and labor mobility have increased in recent decades (*cf.* Matzler & Renzl, 2006). The commitment previously shown by employees to their jobs and employers has thus given way to greater transience in deference to more lucrative career opportunities (Arnett, Laverie, & McLane, 2002).

Investing in productive, responsible staff represents a type of asset development necessary for the success of the company. Ongoing training and employee empowerment



continue to be necessary, despite the greater difficulty that restaurant managers may have in holding down attrition. Along with strong supervisory leadership, good training and empowerment programs can still lead to employee loyalty and increased productivity (Arnett *et al.*, 2002; Matzler & Renzl, 2006). Such investment therefore decreases labor costs, which results in a more competitive and efficient team environment. Controlling costs is a time-honored business imperative, but being able to control costs during good economic times improves companies' ability to excel in less prosperous times, and this talent usually demands strong managerial experience.

### **Purpose and Objectives**

#### *Restaurant labor costs*

The goal of this review is to explore the sources of uncontrollable labor costs in restaurant management. An underlying premise in this endeavor is that employee pay may sometimes be too high, but employee support may alternatively be too low, which increases costs by increasing error. Also, gaps between what customers expect and what they receive, such as when employees misunderstand and therefore fail to project the firm's espoused strategy (*e.g.*, an untrained employee may presume that his customers want value in a high-priced restaurant, or extremely dedicated service in a value-oriented one), may be a source of labor cost. Ultimately, this paper seeks to promote further research into identifying the specific criteria that govern the relationship between the use of labor resources and the goal of operating efficiency, mainly with a focus on internal marketing as a means by which to control labor costs. The resulting insights may permit restaurants to increase their operational efficiency and hence their profit margins. In turn, strong profit margins lay the basis for restaurants' continued operational viability and hence support for the many jobs that depend on their success. Accordingly, this study will evaluate cost

controls in staffing, training, and work scheduling, along with its primary focus on internal marketing. This study will also address strategic considerations to qualify some of the recommendations for improvement on the matter of controlling labor costs.

### *Practical concerns*

The practical objective of the present research is to develop ways by which to address inefficiencies that stem from the use of labor resources without cutting the service quality or the value-added dimension of the material experience. In this vein, it is important to note that some restaurants must emphasize service and menu quality, while others seek mainly cost control and accordingly set consistent, rather than strictly superior, quality expectations (David, 2007; Porter, 1980, 1985; Thompson, Strickland, & Gamble, 2007). Therefore, insofar as the present study refers to cost control, the implicit understanding is a relative one, namely, that differentiator organizations must manage costs adequately, but only as a secondary consideration to service and menu quality, while cost leader organizations must master their supply chain costs, without risking of quality consistency (Porter, 1980; Voss, Lucas, & Krumwiede, 2010). Meanwhile, for all restaurants, consistency in the restaurant “concept” must remain strong (Parsa, Self, Njite, & King, 2005, p. 314). The observations made herein may thus be useful for evaluating current operations and addressing inefficiencies without cutting service or quality, within the parameters of the respective strategic model.

### **Justification**

#### *Need for more focus on restaurant operations*

While there is much research that addresses labor costs in a general sense, whether from an economic standpoint or from that of accounting, there needs to be more that addresses the unique challenges faced by restaurant managers. As Parsa *et al.* (2005) demonstrated, the sources

of failure among restaurants are often idiosyncratic to the industry. Observations of the criteria for success in the hospitality industry in general are often applicable to restaurants in particular, but they are also often too broad to match the particular needs of restaurants (*e.g.*, the prominence of the role of the owner's family in the success of the enterprise; Parsa *et al.*, 2005). A good example of the uniqueness of the restaurant industry is its special vulnerability to increases in the minimum wage (Aaronson *et al.*, 2008).

#### *Need for practical recommendations*

The research into labor costs in the restaurant industry is meager, despite its manifest importance. To be sure, practical advice for effective restaurant management as drawn from experience is readily available (*e.g.*, Smith, 1996), but interpreting theoretical research into practical advice remains important. In addition, there are many articles and books on controlling costs as a whole in the restaurant business, mostly in the form of textbooks. Judging from Parsa *et al.*'s (2005) findings, however, it seems that practical recommendations on controlling labor costs with an emphasis on restaurant management is still in its early years. Restaurant operations influence a large, dynamic segment of the hospitality industry, one that represents a significant portion of the hospitality sector of the nation's total consumer expenditures.

#### *Need for research that includes internal marketing*

As with the question of the availability of research that addresses labor costs in restaurants, there needs to be more emphasis on internal marketing in this industry. Most of the available sources that have some relevance to internal marketing fall short of discussing it directly, but rather attend to some aspect of the practice, without engaging in a systematic discussion of the whole from a theoretical perspective. The present study found eight sources that address the topic directly (Arnett *et al.*, 2000; Foreman & Money, 1995; Frost & Kumar,

2000; Grönroos, 1981; Quester & Kelly, 1999; Rafiq & Ahmed, 1993, 2000; Varey, 1995), but none of these addresses restaurants, and only one (Arnett *et al.*, 2000) addresses the hospitality industry directly. Indeed, internal marketing had suffered from a more general dearth of adequate research at least through the mid-1990s (Foreman & Money, 1995). The definition has been inconsistent and confusing, as the line between internal marketing and ordinary HR practices risks losing clarity this way (Foreman & Money; 1995; Rafiq & Ahmed, 1993). Nevertheless, internal marketing stands to offer deep insights into restaurant operations, given its ability to address poor employee satisfaction (Arnett *et al.*, 2000).

### **Constraints**

#### *Depth*

The present review is selective on the matter of the literature review, rather than exhaustive. Its goal is thus to identify the major themes that the current and seminal literature present in terms of offering insights into the causes, consequences, and solutions relating to labor costs as a function of the effective management of labor resources. An exhaustive review, such as that by Rafiq and Ahmed (2000), would include a maximal number of sources appertaining to the selected topic. By comparison, the present review seeks merely to trace an optimally direct route from theory to practice.

#### *Internal marketing*

Because the focus in this study is on labor costs, the internal-marketing emphasis only refers to Foreman and Money's (1995) Type IV category, namely, communication from the organization (*i.e.*, its managers or agents, including supervisors) to the organization, in the form of its service employees (and by implication effectively to the entire organization). This is indeed the major type of internal marketing discussed in the literature and the only one, for example,

that implicates human-resource practices as a necessary underpinning. Nevertheless, while Foreman and Money (1995) have noted that indeed most of the internal-marketing literature actually addresses only this type, it is important to observe, for the sake of completeness, that other types of internal marketing exist as well, and they happen to lie outside the jurisdiction of interest of the present study.

### **Plan of Study**

This study will first undertake a review of the literature that relates to labor costs and internal marketing in the restaurant industry. The literature search itself will look for how researchers have treated the question of labor costs in the restaurant industry, particularly with regard to how these affect operating efficiency. Other literature sought may include practical insights into operating practices that seem to support efficient service methods. The expectation is that employee selection, training, and scheduling have an indirect effect on costs, while the HR functional area of employee relations, which implicates both leadership and internal marketing, is a key source of indirect costs.

After the literature review, the study will proceed with an analysis of the observations made from the selected research. This treatment of the results of the synthesis of sources will first discuss the effect of internal marketing on labor costs, with ancillary considerations of recruitment, selection, employee compensation, performance management, and training, and then consider strategic insights. Enumerated recommendations relating to cost controls and internal marketing will follow. These will apply principles of generic strategy and strategic posture to distinguish among systematically distinct strategic conditions (Porter, 1980; Miles & Snow, 1978). Lastly, the conclusion will address implications for practice in the restaurant industry and possible themes for future research.

## Glossary

Of interest in this study is a selection of key terms used in the hospitality industry. These include the following:

GAAP.....Generally Accepted Accounting Principles (GAAP), also known simply as Accounting Standards, refers to the standard framework of guidelines for financial accounting across industrial and political jurisdictions (Horngren *et al.*, 2003). GAAP criteria supply information in a usable, consistent format to interested parties external to the enterprise, including private investors and regulatory agencies (Jones, Price, Werner, & Doran, 1996).

Hospitality.....Hospitality is the provision of a supporting relationship from host to guest, wherein the guest is typically someone who is away from home (Barrows & Powers, 2009). This includes the reception and entertainment of guests, visitors, or strangers, and the management of resorts, membership clubs, conventions, attractions, special events, and other services for travelers and tourists. Hospitality emphasizes a fuller and more personal range of amenities than is the norm for service industries in general.

HR.....The human-resource (HR) function in any organization is a supporting operation that includes recruiting, selecting, compensating, appraising, and training employees (Mondy & Mondy, 2012). It is also construable as including an employee relations function, much of which consists of informal mechanisms of information and communication.

IM.....Internal marketing (IM) of the limited type discussed in this study refers to the organization's relationship management practices *vis-à-vis* its service

employees (Foreman & Money, 1995). In the complete service profit chain, this includes both front-office employees and their back-office counterparts, and their own interrelationships (Heskett, Jones, Loveman, Sasser, & Schlesinger, 1994).

POS .....Point of sale (POS) refers to a key location of interaction between a retailer and a customer (Egan, 2007). Thus, a POS transaction is one that occurs at that location, namely, a short cycle to exchange goods or services for contractual consideration. POS promotion refers to marketing materials at that location. A POS terminal includes hardware and software for carrying out this process.

Quantitative....Strictly construed, quantitative measures refer to observations that one first perceives as mathematical properties, such as sheer counts of inventory, money, personnel, hours, and space. The meaning changes when applied to employee performance appraisal, wherein quantitative measures also include qualitative criteria, which the appraiser reduces to numerical representations (Grote, 1996).

Qualitative.....Qualitative measures refer to prosaic descriptions of observations, irreducible to numerical representations. Their value is in their explanatory richness (Ball, 1988; Frick, 2002). Qualitatively defined traits in employee performance appraisal become rational mathematically when reduced to dimensional form based on the appraiser's judgment (Grote, 1996).

USAR.....The Uniform System of Accounts for Restaurants (USAR) is a comprehensive source of data and account management guidance to

support restaurant operations and accounting (National Restaurant Association, 1996). This source also includes key industry ratios for benchmarking purposes (Dopson & Hayes, 2010; Pizam, 2005; Weygandt *et al.*, 2008).

## **Literature Review**

### **Labor Costs**

#### *Turnover*

Hinkin and Tracey (2000) addressed the cost of turnover. Turnover most directly affects the costs of recruitment and training, whose frequency increases in proportion to the level of attrition. Turnover's effect on training, however, takes on additional magnitude because attrition also obliterates the experience curve, which is a source of great customer service value in restaurants. Meanwhile, the intent of an employee to leave often manifests itself in the form of reduced concern for customers, given the employee's reduced organizational commitment. Studying the causes of turnover in American and European hotel chains, Wasmuth and Davis (1983) found that people tend to leave because they grow dissatisfied with their jobs, rather than necessarily due to the prevalence of higher-paying jobs elsewhere. The authors found turnover rates in full-service restaurants to be as high as 100%. Two decades later, this seems to have increased, as only the "high-volume casual and fine dining" category falls short of that figure, at 94%, while "casual dining" is at 108% (Berta, 2008).

Hinkin and Tracey (2000) reported a trio of large retail stores in New York, two of which control costs by keeping staffing levels low, minimizing the depth of training, and depriving employees of decision-making latitude (*i.e.*, empowerment). One store, however, does the opposite, investing heavily in up-front training, empowering its employees, and staffing more in



line with expected demand than with an eye to sparse coverage. Turnover in the latter is very low, and its labor costs are accordingly the lowest of the three. Heskett *et al.* (1994) reported similar findings, noting that the cost of replacing an experienced automobile sales associate (specifically, 5-8 years in the example) with a novice might amount to \$36,000 in sales. As they explained in another example, “Conservatively estimated, it takes nearly five years for a broker to rebuild relationships with customers that can return \$1 million per year in commissions to the brokerage house—a cumulative loss of at least \$2.5 million in commissions” (p. 167).

Ball’s (1988) study on labor seasonality reveals a central consideration for restaurants, because seasonal demand can be quite acute in some venues, namely, those that operate in geographical areas that experience heavy seasonality themselves. This intensifies the issue of labor costs, because labor of the needed quality may be difficult to recruit for jobs that must be temporary by their very structure; however, restaurants would be incapable of controlling labor costs without seasonal hiring. While this task is objectively challenging, Ball’s (1988) analysis shows that quality labor is nevertheless available for the creative HR manager, especially to support small fluctuations in staffing, rather than large ones.

### *Training*

Ball’s (1988) study of labor seasonality indirectly emphasizes the importance of strongly targeted training programs that are consistent with the degradation of the experience curve that results from seasonal hiring. In cases in which restaurants must seriously alter staffing levels at different times of the year, up-front training must logically be rapid and intense, and therefore costly. As one way to counteract such upward pressures on training costs, Enz and Siguaw (2000) reported some hotel chains’ use of “buddy training” to help control training costs in smaller operations (p. 54). This is actually a type of dedicated coaching, wherein a previously

trained employee teams up with a new employee to enable maximal training on site, rather than having to draw all new employees to a corporate office for collective training, a more expensive operation that only makes sense if a corporation has achieved the requisite scale overall. Training of this type is most effective when there is sufficient oversight and ongoing review of progress to motivate the experienced employee to stay on course. Enz and Siguaw (2000) suggested that this technique is most effective for small hotel chains, so it may also be a technique to consider for sole-proprietorship restaurants and small restaurant chains.

Arora and Singer (2006) addressed employee management for high-quality restaurants. The authors focused on the fact that fine dining in particular depends on its ability to evoke positive emotions in customers, from the specific act of experiencing the core process, namely, actually consuming the meal. During this time, fine-dining restaurants have opportunities to enhance the emotional experience through the style of presentation and positive surprises along the way. While this seems to imply exclusivity in recruitment and selection, along with intensive levels of training, which are appropriate in a differentiated firm (*cf.* Porter, 1980), Smith's (1996) practical tips for restaurant success mainly address the focused firm. Thus, the latter gives advice for greater success in restaurant management by remembering customers' names and "feed[ing] the ego as well as the appetite," which imply the recruitment of experienced, highly extraverted servers, or else their training in tactics to enable assigning a name to a face and engaging in aggrandizing conversation (p. 44). The selection function receives additional emphasis with the suggestion to hire "friendlies" (p. 44), or people who manifest strong attitudinal competencies in "smil[ing] easily under stress (p. 45). Although Arora and Singer (2006) tended to emphasize selection more than training, several observations create clear implications for training *per se*. For example, they listed "seating order, wait time, staff politeness, [...] and server attentiveness"

in their discussion of the necessary attributes of fine-dining establishments for eliciting customer satisfaction (p. 54). It is also important to note that training is a source of the employee's access to resources, namely, intellectual and attitudinal abilities. A lack of training sufficient to meet the demands of the service environment will have the same consequences as the outright absence of silverware.

#### *Other labor cost management approaches*

On the matter of HR staffing, Smith (1996) focused mainly on this functional area as a way to control labor costs *per se*, including carefully planning sparser staffing during weekly periods of slow demand, which implies more intensive tracking of demand and planning for coverage. For Enz and Siguaw (2000), cost management similarly involves mainly creative staffing approaches to reduce wages and salaries. Meanwhile, Thompson (1996) studied the effect of employee scheduling on hospitality industry success, by focusing on "action times" (p. 82). These refer to shift changes, which can present a challenge to supervisors who need to ensure service continuity across the changes. The author found that it is indeed possible to engineer more or fewer action times without complicating the coordination of service delivery; consequently, managers should plan more or less frequent action times based on other criteria (*e.g.*, stable *versus* volatile or seasonal customer demand).

Empowerment is another topic that has emerged occasionally in some sources (*e.g.*, Enz & Siguaw, 2000; Ottenbacher & Gnoth, 2005). For Enz and Siguaw (2000), empowerment requires a combination of training employees to judge situations more accurately, while giving them the freedom to make immediate decisions based on their own judgment. Meanwhile, recognition constitutes a supporting practice and involves employing a combination of monetary and non-monetary rewards for outstanding performance. Ottenbacher and Gnoth (2005) similarly

found empowerment to be important for achieving an innovative climate, along with effective training, other HR practices, and processes to build employee commitment.

Ball's (1988) study of labor seasonality mainly implicates effectiveness in recruitment, because managers of restaurants that experience heavy swings in customer demand at specific points in the year must be capable of recruiting effectively to facilitate training; that is, recruiting people with insufficient experience increases the burden on training to make up for the difference. The relatively heavy need for up-front training at the start of seasonally strong periods in these environments places downward pressure on wages to compensate for that greater expense. However, as Ball (1988) found, there is an ample labor market available, including college students, stay-at-home mothers, and retirees, to whom the relational returns of the work (including the value of the training) are sufficient to offset any wage decrements. Among these groups, as Ball implied, the restaurant manager's ability to retain a steady list of repeat workers year after year can be a key to controlling costs.

### **Internal Marketing**

#### *The service profit chain*

Heskett, Jones, Loveman, Sasser, and Schlesinger (1994) discussed the importance of the service profit chain in identifying potentially weak points in the linkages among activities that ultimately result in strong or consistent customer service. In their model, internal service quality leads to customer satisfaction, which in turn leads to customer loyalty. Supporting internal service quality are employee selection, training, compensation (including variable incentives), and recognition. Employees' effective use of the available tools is also a necessary part of this value chain. The authors described external service value as that value that customers actually perceive. This grows out of the combination of employee retention and employee productivity,

and those two outcomes in turn grow out of employee satisfaction. Varey (1995) similarly explained that external service quality is that aspect of the organization's service that customers perceive. According to Heskett *et al.* (1994), the service profit chain features "internal service quality" at the beginning (p. 166). This incorporates a full range of HR activities that overlap with internal marketing, starting with workplace and job design.

Frost and Kumar (2000) performed a factor analysis of items from an "internal service quality model" to explore the viability of using such a device to measure internal service quality (p. 358; *cf.* the beginning of the service profit chain of Heskett *et al.*, 1994). Applying the concept to the airline industry in substantial detail, the authors' intention was to address the internal gap between expected and perceived service from the perspective of front-office personnel. Referring to the discussions in Heskett *et al.* (1994) original study of the service profit chain, Frost and Kumar (2000) argued that organizations inadvertently push employee concerns to lower strata of priority as those organizations grow. Viewed as internal customers, front-office personnel then experience a gap between the level of internal service quality that they expect and that level that they actually perceive at the point of each internal exchange. Moreover, back-office (*i.e.*, support) personnel interpret front-office expectations and act on that basis, only to fall short of those perceptions in some measure, insofar as they lack general organizational support for empowered decision-making. Frost and Kumar (2000) identified five specific performance gaps that occur within an organization, between back- and front-office processes. Should an organization fall short in providing sufficient support to its employees overall, the effect is to magnify decrements in performance substantially before the customer ever experiences the results of those internal processes.

*IM practices*

Rafiq and Ahmed (1993) examined the boundary between internal marketing and human-resource management. They found that the concept of internal marketing had suffered from imprecise definition, so they recommended a broader interpretation of the phenomenon, more in line with total quality management (TQM) practice, wherein one treats employees as though they were customers, rather than attempting to define them literally as customers in the economic sense. Rafiq and Ahmed (2000) returned to the challenge of finding clarity in the definition of internal marketing after seven years. They found that the concept had continued to suffer from imprecise definition, while its actual use in industry was still very sparse. In order to help move the research along in a direction of unifying the definition of the term, the authors traced specific phases of development in the history of its usage since its founding.

In the first phase (from 1971), internal marketing referred to “employee motivation and satisfaction” (Rafiq & Ahmed, 2000, p. 450). The second phase constituted a “customer orientation” (p. 451). This started with Grönroos (1981), who had emphasized the customer service employee’s dual role, as salesperson and marketer. To be sure, the Grönroos view may actually imply marketing internally at least as much as it implicates internal marketing. The third phase (starting in 1985 but becoming prominent in the 1990s) broadened the scope of internal marketing and finally made it a strategic consideration.

From these three phases of conceptual development, Rafiq and Ahmed (2000) synthesized five key criteria for internal marketing. The first involves “employee motivation and satisfaction,” following the original definition and first phase of the concept (p. 453). The second involves “customer orientation and customer satisfaction,” which corresponds to the Grönroos definition (p. 453). From the current conceptual phase, the remaining keys of “inter-functional

coordination and integration,” “marketing-like approach to the above,” and “implementation of specific corporate or functional strategies” emerge (p. 453). The authors then constructed a model to depict all of these variable and their relationships with one another. The core of their model consists of a unidirectional causal chain, from “marketing approach,” to “customer orientation,” to “service quality,” and finally to “customer satisfaction” (p. 455).

Foreman and Money (1995) provided an overview of internal marketing, from a very broad perspective. Their approach addresses all levels of concerted activity within an organization, aimed at influencing the choice behavior of other constituencies. They provided a model to divide the specific types of internal marketing, into one group’s marketing itself to another group (Type I), the organization’s marketing itself to a group (Type II), a group’s marketing itself to the organization (Type III), and the organization’s marketing itself to itself (Type IV). As applied to the restaurant industry, Type I internal marketing may take on the form of the kitchen staff’s proposal of changes in process rules to the inventory manager, who must adapt to any new rules that affect his own processes. Type II might involve the organization’s proposal, by means of the managerial structure, to change the work hours of the service staff. Type III would include a request by the custodial crew to permit clean-up work to wait until after closing time, rather than before the customers have left. Type IV internal marketing refers to the organization’s treatment of its entire workforce, and therefore it involves ensuring smoother transitions across process boundaries (especially between front- and back-office activities), stronger support overall (*e.g.*, sufficiency of access to resources or help from management), and good human-resource policies (*e.g.*, effective, strategically relevant training).

Although this last category seems hardest to comprehend, the authors have noted that most of the research on internal marketing had actually involved this one by the time of their

writing. In fact, this category actually refers to an organizational agent's marketing its function to the entire organization. Therefore, it is the type of internal marketing relevant to the present study. By "group," the authors meant a subsidiary unit within the organization, acting on its own behalf rather than as an agent of the whole organization (Foreman & Money, 1995, p. 760). Referring implicitly to Type IV internal marketing, Arnett *et al.* (2002) explained that "internal marketing has both an internal (employee) focus and an external (customer) focus" (p. 88). Thus, it is more than merely an example of good employee relations, because it connotes a logical chain of perception and action from back-office internal to front-office internal relationships, and thence to the final customer.

Varey (1995) provided a very detailed model for internal marketing. To clarify the meaning of the concept, Varey (1995) stressed the importance of viewing it as the interaction of several functional areas, or "technologies," including human-resource management (specifically, training and employee relations), operations management (specifically, quality management), organization development, business strategy as a whole, and "macromarketing" (p. 48). As a consequence of his effort to broaden the view of internal marketing, Varey (1995) introduced a new specification of the term to help guide research and practice, namely, "internal relationship marketing," or more scientifically "internal social process management" (p. 49).

Quester and Kelly (1999) studied internal marketing in Australian financial companies. The authors listed mostly HR practices, including employee relations, and motivation as constituting the essential facets of internal marketing. Specifically, recruitment, selection, training, and retaining employees constitute the traditional HR functions, while specific employee relations functions include practices to promote effective communication and the provision of needed information. The authors' goal was to see whether internal marketing



practices fall within the acknowledged domain of employment practices in Australian financial firms. Operationalizing internal marketing in the form of an array of very specific, concrete practices (*e.g.*, corporate videos, leaflets and brochures, and training courses), which overall simply represent communication and information (in addition to limited motivational practices, such as the provision of awards), they found that large companies use these methods more than small ones.

Varey (1995) listed 12 detailed descriptions of activity that he expected to contribute positively to internal marketing. A subset of these consists of involvement programs, frequent employee interviews, clarity in terms of how each performance criterion contributes to specific organizational goals, the use of self-managing teams, segmenting internal customers by need category, measurability of individual performance measures, rewards tied clearly to performance goals, and role model recognition. Varey also suggested releasing employees from routine tasks to interact more freely with external customers, strong attitudinal training, enabling strong working relationships across internal units, and “a framework of concepts and skills” to support process improvement goals (p. 51).

Enz and Sigauw (2000) examined human-resource practices in hotels. Their study effectively addressed the key areas of Type IV internal marketing, namely, leadership development, employee training, empowerment, recognition, and cost management. Leadership development involves formal training structures to instruct in attitudinal competencies. Thus, personnel in leadership positions learn to accustom themselves to engaging in leadership behavior intuitively, while strengthening those attitudinal patterns by performing specific, proactive behaviors to address specific issues (*e.g.*, communicating with subordinates regularly, providing coaching at opportune moments, and addressing deficiencies using an optimal

combination of leadership traits). Employee training on the service side also involves attitudinal competencies, mainly in the form of modes and habits of interaction with customers. Thus, internal marketing as it applies to the whole firm consists of effective interaction both along the value chain (*i.e.*, between phases of service delivery, including the transition between the front and back office) and in terms of the overall support structure (especially human-resource management, hence pay, benefits, and employee relations).

### *IM outcomes*

Arnett *et al.* (2002) studied job satisfaction and internal marketing. They listed key practices for maintaining strong levels of job satisfaction and indeed instilling pride in their customer service personnel to support a change in vision include recruiting for fit with the new vision, training accordingly, and motivating consistently. They listed the key factors that predict job satisfaction as being role clarity, positive evaluations of both management and organizational rewards systems, and the quality of the work environment. They also listed the key factors that predict organizational pride as being, again, positive evaluations of management, in addition to how well the organization actually performs. The combination of job satisfaction and pride thence predict positively toned employee behavior (p. 89). According to Heskett *et al.* (1994), customer loyalty is a product of customer satisfaction, which in turn is a consequence of “external service value” (p. 166).

Wasmuth and Davis (1983) found that employees’ intent to leave in the hospitality industry usually follows dissatisfaction with supervisors or working conditions (*i.e.*, standard facets of job satisfaction; *cf.* Herzberg, Mausner, & Snyderman, 1959). To be sure, departing employees in their study also frequently cited pay as their rationale, but dissatisfaction with other aspects of the job dominated the commentary. In their replication of the Wasmuth and Davis

(1983) study, Woods and Macaulay (1991) duplicated those results and reported confirmation of Wasmuth and Davis's (1983) original findings. Job dissatisfaction is a critical source of cost in the hospitality industry.

Ruiz, Gil, and Berenguer (2008) studied customers' perceptions of relational benefits. Relational benefits refer to sustained perceptions of non-commodity value that emerges from customer service interactions. The authors noted that prior studies had already established that relational benefits enhance customer loyalty and prolong customer relationships with the organization. Employing a multi-item survey, the authors performed a factor analysis, which ultimately resulted in a four-factor solution. The authors labeled these factors "confidence benefits," "social benefits," "special treatments benefits," and "loyalty" (p. 502). A structural-equation model then depicted expected causal relationships among the factors, such that the first three factors would predict the fourth. Social benefits fell short of significance in the actual test, while both confidence benefits and special-treatment benefits significantly predicted loyalty. Preceding this finding, Arnett *et al.* (2002) had observed that successful internal marketing reduces turnover, and increases satisfaction, which subsequently increases service quality. Turnover drops when satisfaction rises, which in turn comes from greater engagement. Engaged employees feed the satisfaction of guests, which in turn reflects well upon the employees, who enjoy better supervisory reviews and sheer enjoyment on the job. As Arnett *et al.* note, engaged employees "are more likely to take actions that result in increased guest satisfaction and profitability" (p. 88). This greater engagement comes from greater role clarity, an expectation that rewards actually follow performance, access to needed resources to perform one's tasks, responsive managers, and pride in the enterprise itself (p. 92). In turn, service quality facilitates the organization's efforts to induce change.

## **Strategic Issues**

### *Restaurant failure rates*

Parsa *et al.*'s (2005) groundbreaking study of restaurant failure rates found that the actual incidence of restaurant failure is less than what most writers had presumed. Indeed, a popular misconception is that the restaurant failure rate is around 90% (p. 305). In fact, the authors found that the first-year restaurant failure rate is actually about 26%, followed by 19% more by the end of the second year, and 14% more than that by the end of the third year (p. 310). This amounts to a mean failure rate of about 60% overall by the fourth year. This is still a high failure rate, but Parsa *et al.*'s (2005) significant contribution is to inject needed objectivity into the discussion. As a strategic analysis would have expected, failure rates are highest where there is the greatest restaurant density (for which measure the authors used units per ZIP code rather than units per square mile), and so is the frequency of changes in ownership. Interestingly, the authors also found significant differences in the likelihood of a change in ownership (3-year cumulative) by restaurant type. They found that Mexican restaurants change ownership 87% of the time in their first three years, while seafood restaurants change ownership only 33% of the time.

### *The lack of concept*

If employees deviate from the central concept that draws customers, the result is greater cost to the employer in the form of greater error in service delivery and lower revenues (from confused customers). This may come about either because employees fail to convey the tone associated with the type of business in question (*e.g.*, lack of motivation), or because they lack the training necessary to undertake preparations associated with it (*e.g.*, the look of the table, or the sense of commitment demonstrated in a memorized line). Parsa *et al.* (2005) concluded that “concept” is more important than “strategy” in the conventional sense (p. 314). They defined the

notion of concept as that combination of product emphasis and mode of delivery that “not only provided a food product but also included an operating philosophy, which encompassed business operations as well as employee and customer relations” (p. 315). This is different from merely knowing what kind of food to offer. As the authors observed, failed restaurants “would state that their concept was ‘vegetarian food,’ or ‘Alaskan seafood,’” but they never contemplated any overarching theme in their style of delivery (p. 315). Aside from what this implies in recruiting and training employees to know and project the theme, the central point is that the quality of the food often fails to draw the target market by itself. The authors provided a striking example of a concept problem with the illustration of a nightclub that sought to operate “across the street from a police station” (p. 317). Reflecting customers’ sense of freedom from authority in a nightclub environment, even if only as willful suspension of disbelief, the police station offered a constant signal that authority was nigh. Rather than incorporate a theme of defiance of authority (which is indeed possible in a nightclub), the attitude of the servers was evidently to try to ignore it, which naturally failed. Ethnic restaurants require “authenticity” to be successful, while all restaurants require “conceptual integrity,” “differentiation,” or “distinctiveness,” rather than “[b]ecoming everything to everyone” (p. 317). A restaurant demands a uniform sense of “direction” (p. 317).

To be sure, this notion of concept is distinct from strategy only insofar as strategy may be perceptible without the sense of a driving theme or manifest identity. The analysis of strengths, weaknesses, opportunities, and threats (SWOT) is important, along with the various approaches to matrix analysis that are available (*e.g.*, the Boston Consulting Group typology; Henderson, 1979), but Parsa *et al.* (2005) have observed that analytical strategy alone is insufficient. To explicate the meaning further, the authors continued by listing as a source of failure the “lack of documented strategy,” noting that failing restaurants often used “only informal or oral

communication of mission and vision,” without nurturing an “organizational culture” to help build and consolidate “success characteristics” (p. 317). Restaurant failure was also a product of the lack of “formalize[d] operational standards,” such that restaurants often employed “seat-of-the-pants management,” or “putting out fires” instead (p. 317). The authors noted that “mission drift” was a problem with failing restaurants (p. 304). The authors added that “focusing on one aspect of the business at the expense of others” was a related problem (p. 317). They added “diverse views of the mission, vision, and objectives” as a common problem (p. 317). As the authors noted, “fail[ing] to integrate vision and mission into the operation,” or simply taking too long to reach that point, is a common source of restaurant failure (p. 317).

### *Strategic orientations*

Although the restaurant literature is sparse on the question of best practices for a cost leadership establishment, Smith (1996) provided a series of 13 practical tips for success in managing a restaurant, mainly directed at sole proprietorships that must specialize in consistent, rather than refined, quality and strong cost control. More specifically, the author seemed to be addressing focused cost leaders, in Porter’s (1980) strategic model, which also correspond to Miles and Snow’s (1978) defender type.

Varey (1995) distinguished between the “external strategic sphere” and the “internal operational sphere” (p. 47). Arora and Singer’s (2006) study on creating an emotional return in fine-dining establishments illustrates some of the distinctions between a differentiated firm in Porter’s (1980) model and cost leader firms. Specifically, the emphasis that the authors placed on those elements in the service process that represent an entertaining, engaging demonstration of expert service delivery and meal presentation suggests intensive training, exclusivity in selection, and relatively high wages.

Ball's (1988) investigation into the quality of seasonal labor provides some insights into seasonal recruitment and training strategies. These include careful labor market scanning to identify specific categories of people in the relevant geographical areas whose own lifestyle makes seasonal work attractive, despite the low wages that it necessarily entails (due to the cost of repeated training at the start of each strong season). Such groups include college students, retirees, and stay-at-home spouses. Seasonally oriented staffing strategies may also benefit from identifying employees who may be willing to work each season in that capacity.

Reynolds (1998) provided a way to perform a productivity analysis of food service employees, emphasizing that the traditional methods for meeting this objective often lead to misleading results. Reynolds described the traditional productivity measure as equaling the total creation of goods and services divided by the combination of labor, material inputs, energy, and capital. Her solution is to put revenue for a given period in the place of the numerator, and then focus on costs in the denominator. In this model, costs should include labor, inputs, and "amortized leasehold improvement," which she described as self-explanatory (p. 26). The result is a very comprehensible productivity index that is greater than one as long as the company is making any kind of positive revenue before counting off remaining overhead and taxes. Reynolds (1998) also provided simple ratio measures of productivity to apply to food services in both the education and the healthcare management industries. His aim was to question the common equation in which total productivity equals goods and services divided by inputs (*i.e.*, labor, material, energy, and capital). Because the common approach includes profitability, it confounds profitability with productivity and thus deprives the planner from attending to the latter when necessary. Reynolds' (1998) recommended measure of productivity in standard restaurants is a function of revenues divided by the combination of "productive labor cost," the

actual cost of goods consumed, and “amortized leasehold improvements,” for a finite period of time (p. 25). The reason for the last item is that refinements to the premises are a cost associated with revenues, so ignoring it will inflate the appearance of productivity.

Gil, Ruiz, and Berenguer (2008) studied wine list structuring to infer how upscale restaurants actually use this potential method of strategic differentiation. Their results, from an analysis of data only from Spain, demonstrate that the owners of upscale restaurants usually play a prominent role in selecting wines for these lists, and that the primary drivers behind that selection are more idiosyncratic than strategic. Despite the potential strategic importance of wine menu engineering, few upscale restaurants in the author’s geographic area of focus actually consider this. Nevertheless, this idiosyncratic approach seems to imbue the restaurant with a certain level of prestige that it would lack by adopting a more formulaic approach.

Quain, Sansbury, and LeBruto (1999) studied restaurant profitability. This is a very practical article, which demonstrates the traditional method for undertaking menu engineering, namely, by assessing contribution margins per item. Contribution margins refer to the simple difference between the cost of a menu item and its menu price. The authors offered several strategic to improve the effectiveness of the menu mix on restaurant revenues. Some of these strategies include offering specials, selectively increasing portion sizes (*i.e.*, offer a larger option for certain items, alongside the standard-sized item), cutting back on entrée sizes to accommodate dessert, and tracking individual customers’ purchasing patterns.

Raab and Mayer (2007) studied the question of how well it might be possible to apply activity-based costing (ABC) to menu engineering in the restaurant industry. As Hansen and Mowen (2003) defined the concept, “Activity-based costing assigns the cost of activities to individual products based on their relative consumption of the individual activities” (p. 438).



Raab and Mayer (2007) addressed the question of whether considerations of contribution margin alone (*i.e.*, item menu price minus item cost) suffice for effectiveness in menu engineering. Applying this new concept to a buffet restaurant in Hong Kong (which has a relatively high rent rate), they found that a careful analysis of the time spent on specific categories of front- and back-office activity produces a far more accurate appraisal of the actual cost represented by each menu item. Within each activity center (*i.e.*, back or front office), the authors specified an assessment of batch-level activity (*i.e.*, that activity that is definable as the output of the front or back office alone, as opposed to the entire restaurant, which would constitute unit-level activities during service hours), and “product-sustaining” activity, which refers to general administrative processes (p. 45). Estimating costs per minute, based on an identification of the relevant labor costs in each kind of activity, they were able to estimate a total cost per minute that it takes to run the restaurant on average. Applying this same method to each customer instance (*i.e.*, the average customer) and instance of the preparation of a menu item (performed for each menu item), the authors were able to compute both an actual total cost per customer and an actual total cost per menu item. In turn, this enabled them to analyze the entire menu. Their final recommendation was to categorize menu items according to the Boston Consulting Group (BCG) growth-share matrix, as star items, dogs, and so forth (Henderson, 1979). This approach enables the manager to identify which menu items are resulting in negative operating profits (dogs), to differentiate them from the rest and possibly to revise those items. A recommendation in the use of the ABC method of costing is to scrutinize areas with high-cost labor markets, such as is true in many urban centers in the United States (Raab, 2011, personal communication).

## **Results and Recommendations**

### **Results**

This foregoing literature review has addressed how labor costs affect operating efficiency, while offering insights into ancillary areas of the research that may affect related aspects of restaurant functioning. Employee staffing, training, scheduling, and relations have direct or indirect influences on restaurant success measures. Similarly, internal marketing stands to contribute deep insight into optimal practice to cutting attrition. Lastly, strategic considerations are important as a function of guiding concept, rather than merely analysis.

Restaurants have high failure rates, although the actual incidence of restaurant failure is lower than popular assessments might suggest (Parsa *et al.*, 2005). This fact has a systematic cause. After reviewing many successful restaurant businesses, researchers such as Parsa *et al.* (2005) have established that the successful cases effectively follow a conceptually simple formula, namely, to exceed customer expectations while simultaneously controlling overhead and labor costs. To maintain their competitive edge, these restaurants maintain a habit of tracking and monitoring internally available data and of finding creative ways to cut costs without compromising service or quality (Reynolds, 1998).

### *Competition*

Competition in the restaurant industry is often quite fierce, given the ease with which customers may change their prandial habits without incurring any personal transaction costs. It is therefore imperative to develop an in-depth familiarity with the relationship among the product, customer, and restaurant medium, as well as the competition itself. How management confronts the competition will have a direct impact on the success of the business (Luther, 2001). The first step in the challenge is to assess one's business openly and honestly. For example, in addition to

scrutinizing comparative ratios in the latest edition of USAR, management can visit other establishments and evaluate their best and worst qualities. Crucial aspects in the restaurant business usually include food, service, ambiance, and price, and labor quality affects three of these factors directly. What will give one business the edge over the competitor? In business, such answers often reveal themselves through an arduous journey of trial and error. A good manager reviews his research, evaluates the strengths and weaknesses of the business, reviews strategies, assesses operational costs, makes a plan, and carries out the plan. Assessing one's business openly and honestly will help one develop a competitive edge.

### *Costs*

Keeping operating costs under control will lead to a much larger profit margin. Operating costs include both labor costs and other costs that fall within the direct decision-making purview of the restaurant's managers, in addition to two specific sources of cost, namely, occupancy and depreciation, which will fall outside of that purview (Schmidgall, Hayes, & Ninemeier, 2002, p. 86). As defined by Ingram, Albright, and Hill (2001), operating costs constitute "the cost of resources consumed as part of administrative and selling activities during a fiscal period" (p. 37). As defined by Hansen and Mowen (2003), operating costs refer to "the money an organization spends in turning inventories into throughput" (p. 999). Aside from direct labor, therefore, the other categories of operating cost include the cost of consumable supplies and all overhead. When economic times were good, many restaurants could operate with little more than casual regard for cost control, without noticing anything amiss. People seem to be eating out often, and profit margins are high, particularly in upscale urban areas. As the economy has been slipping over the past few years, however, the cost of doing business has steadily risen. These costs have increased at a significantly higher rate than that of menu prices, and the net effect has been

decreased profit margins, or in many cases outright closures. Food establishments still in business have no choice but to increase prices or decrease operating costs to maintain profits, just as in years past.

The cost of goods sold affects purchasing and menu engineering. Improving one's purchasing power is often just testing one's existing suppliers against other available suppliers. Restaurant managers must avoid losing themselves in the comfort zone of dealing with the same suppliers uncritically. They may be paying too much or overlooking different products that could increase their profit margins. In a bad economy, even one's suppliers are hungry for one's business. It is valid to test the waters and bargain with vendors. One must shop for one's business, both on the customer side and on the vendor side of the value chain. Implementing requisition and ordering systems and using POS systems effectively are standard ways to run sales reports and maintain inventory.

In addition to labor cost and purchasing, menu engineering is another critical area where cost control is applicable. The restaurant manager needs to ensure that there is a good menu mix, which may produce a good margin on menu items (as long as the cost includes the related cost of labor; *cf.* the discussion about ABC menu engineering, above). The kitchen staff should follow recipes carefully, which chefs should create conscientiously and creatively. These will not only provide consistency, but will also help track and control inventory. A restaurant may have the best staff, wine list, and food, but at the end of the day, if it is failing to make any money due to poor pricing, it will soon be out of business (Jones & Mifli, 2000). The correct way to price menu items is first to cost them (Raab & Mayer, 2007), as explained above, because accurate costing enables pricing that leads to profitability, rather than loss. Short of that, a common approach to menu pricing is simply to adopt a price that exceeds the item cost, while falling

within the acceptable range of the target market (Jones & Mifli, 2000, p. 65). After this, managers may adopt strategies to encourage customers' choices to drift from basic items to higher-priced signature items. As Jones and Mifli (2000) explained, tracking actual consumption patterns by item enables restaurants to include menu items as fall below necessary cost thresholds, as long as they tend to motivate customers to those that exceed them.

#### *Employee impact on costs*

Focusing on some of the controllable costs is paramount. Following are some areas that relate directly to the costs of running a successful restaurant, which restaurant managers should consider in the decision-making process. Direct labor costs include employee compensation and employee training. By comparison, work scheduling constitutes an indirect labor cost, because it involves actually managing the labor, especially when a schedule creates unexpected conflict (*e.g.*, when an employee announces an absence at the start of a shift, which creates a chain reaction of perhaps inefficient remedies to make up for the loss). Material costs include supplies. A significant administrative expense is marketing. The employee's effect on portion control is important as well, mainly because consistent portions help maintain consistency in customer expectations, while inconsistent portions due to inadequate training will inevitably displease some customers. Menu development constitutes a potentially significant driver of profitability as well. Outsourcing services to supplant labor expenditures is sometimes a cost-saving device, while at other times the commitment may start out apparently capable of providing efficiencies but later mutate into a cost that exceeds its value.

Both supervisors and staff should be aware of any issues having to do with process or product needs, as well as know what supplies cost (Enz & Sigauw, 2000). Employee error, such as wasting time, breakage, and product waste, will have a direct, deleterious effect on the overall

cost and success of the operation. Restaurant managers must bear in mind that it is their supervisors' responsibility to control employee actions and costs. They should conduct frequent staff evaluations and reviews. These reviews are just another way of improving productivity and reducing costs. Management needs to take the time to watch and assess employee performance. If management discovers that a large portion of the employees' workdays includes inordinately long breaks or downtime, a change in scheduling may be necessary. Conducting face-to-face reviews with each member of the staff will help to communicate with the employees, to get to know their thoughts and concerns.

Investing in good staff is an investment in the success of the company. Ongoing training and employee empowerment create employee loyalty and increased productivity. All of the aforementioned tactics also decrease labor costs by reducing workers' compensation claims and time off for illness, which in turn leads to a more competitive and efficient team environment, while promoting employee ownership.

### *Controls*

The key to controlling costs has less to do with reducing the cost of supplies as it does with maximizing value to the customer. Restaurateurs tend to look at theft, over-portioning, and shrinkage in terms of how they affect them as owners and managers. Theft increases costs, for which menu price increases can compensate. In turn, this decreases the value of the customer's experience, compared to the previous benchmark of lower prices. The long-term effect is lower sales. At first glance, over-portioning looks like a benefit to customers, but unless greater revenues make up for greater waste from unconsumed residue, the result will be greater net costs in the long term. Worse, if over-portioning is inconsistent, that same customer who received the

generous portion the first time only returns to disappointment, upon receiving a normal portion the next time.

Standard costs are another consideration. These refer to the restaurant manager's specifying the expected cost of each product, based on the expected cost of each ingredient in due proportion, the expected cost of the labor applied to preparing it, and the expected portion of overhead expense allocated to it (Hansen & Mowen, 2003). Standard costing is valuable to restaurant operations, because it assigns a budgetable cost to each item, which tends to eliminate the under-costing problem that results from a failure to consider direct labor or overhead. In turn, the emphasis that this method places on assigning a cost value to each item facilitates budgeting, because the manager ascribes a predetermined cost to each item planned. By comparison, "actual costing" ascribes a value to a product by measuring the actual amount of direct materials, direct labor, and proportion of overhead applied to it, while "normal costing" (*i.e.*, the common method) uses a budgeted value to represent overhead, while using the same approach as actual costing otherwise (Hansen & Mowen, 2003). As evidenced by the menu engineering literature, restaurants tend to overlook the labor and overhead contributions to real costs and consequently fail to notice their shortfalls until the end of a period of activity (*e.g.*, Raab & Mayer, 2007).

The literature makes several suggestions for general cost control in restaurants, including cutting back on entrée sizes to accommodate desserts in more cases, which would have the incidental effect of reducing costs somewhat on the entrées themselves (Quain *et al.*, 1999). Spoilage is another issue that affects the bottom line, in addition to customer satisfaction. Using products on the verge of going bad will only produce an inferior product that again leads to decreased sales. Yet this entire source of waste lies within the capability of the employees to control.

Labor costs are usually the largest operating expense for any restaurant establishment. Therefore, when the conversation of reducing labor costs comes up, the first reaction is usually to reduce staff. Although doing so may be the eventual decision, the research shows that this has a negative effect on employee morale, which leads to lower levels of customer service. On this measure, internal marketing is relevant. In addition, simply paying one's employees less in order to cut labor costs will fall short of solving labor cost issues. Underpaying will undermine job satisfaction, which will in turn simply increase turnover, while decreasing service quality prior to departure. The keys to controlling labor costs are improving workplace productivity through proper scheduling, employee satisfaction, and internal marketing (Arnett *et al.*, 2002).

The restaurant business is no stranger to staff turnover. Continuously hiring new staff can become very expensive. The restaurant needs to recruit and train new staff according to projected demand, and failing to plan properly can drive up HR expenses and negatively affect customer relations, service, and productivity. Poor productivity is usually a symptom of poor employee relations, rather than the actual problem. Poor recruitment, poor training, or poor leadership may cause poor productivity. Increasing productivity improves overall operations by building employee skills and confidence. Time and resources must be available for providing staff with sufficient training and opportunities for communication. Cross-training is beneficial to both the employee and the business, and this allows the manager to schedule fewer workers while nevertheless being able to achieve the same production and service standards (Cannon & Gustafson, 2002).

Employee cost control during service hours focuses mainly on the supervisory level. Supervisors are in control of the staff on a day-to-day basis, so they also have the ability to control scheduling, training, and the transmission of directives. For example, supervisors are in a



position to monitor clock-in and clock-out times after every shift, and they can make sure that all employees have punched in and punched out exactly according to the schedule. Next, managers must prevent over-staffing. It is easy to schedule extra employees to make up for expected shortfalls, but scheduling too many employees will increase one's labor costs and reduce overall profit, insofar as some employees may have to wait to work while already on the clock, which in turn will simply hurt the overall business (Loucks & Jacobs, 1991; Thompson, 1996). Training staff to work accurately and efficiently while maintaining a quality level of service is a better option than attempting to cut costs by cutting wages and staffing levels. Communication is paramount to efficiency and employee satisfaction. It is important to discuss all schedules and other changes in advance. This gives employees sufficient time to manage their time and schedules as needed.

### *Internal marketing*

As this paper has sought to discover, internal marketing is a key consideration for controlling labor costs. Probably the best evidence of this is Frost and Kumar's (2000) study, which identify five potential service gaps that exist in the simplest form of back- and front-office structure. Although Frost and Kumar (2000) used the airline industry as their object of analysis, their generic model of internal service quality (p. 366) is applicable to all service operations, and indeed practitioners may build on the model to depict their own idiosyncratic structures more accurately and thereby take advantage of those insights.

Frost and Kumar's (2000) first internal gap refers to the back office's effort to understand and thus support the needs of the front office. If back-office perceptions of front-office needs, which manifest themselves as expectations communicated in a variety of ways (sometimes directly, and sometimes indirectly or incompletely), then there is no gap at that point. The second

gap occurs in the back office itself, between the support staff's perceptions of what the front office needs and its ability or motivation to translate those perceptions into a sufficient quality of back-office support. The third gap again occurs in the back office, this time between the back office's establishment of quality standards (in support of the original front-office expectations) and the back office's actual delivery of service according to those standards. The fourth gap now occurs between back-office service and the front office's perceptions of the actual quality of that service. Finally, a fifth gap occurs in the front office, namely, between the perceived quality of service from the back office and its own original expectations.

Frost and Kumar's (2000) overall message is to try to close all five performance gaps in internal service quality by employing strong internal-marketing techniques. Because internal marketing stands to improve morale, commitment, and motivation among all employees in terms of their delivery of expected services among one another, internal marketing generally should help close these gaps. Contrarily, a failure to promote strong internal-marketing policies yields a magnifying effect on the erosion of external service quality, because even a relatively small gap at any juncture compounds the degree of error as it transmits erroneous information to the next juncture, which is likewise suffering from the same source of error as the previous one.

Expressed mathematically, even in the smallest example of internal service structures, which corresponds to Frost and Kumar's (2000) general model, measured error of just 5% at each gap results in a compounded error of about 22% by the time the customer receives it. Worse, insofar as another gap occurs because the enterprise is seeking first to understand the customer's expectations at the POS point, and so inform the delivered service, this error arguably grows to 34% between customer expectations and customer perceptions of quality.

More specifically, Frost and Kumar (2000) have identified two critical functions on which successful internal marketing depends. These are communication and motivation, with secondary implications for training and coordination. On the matter of communication, the author's model emphasizes the importance of the free and open exchange of information along the value chain (*i.e.*, the service profit chain). The most egregious sources of miscommunication come from fractal vertical polarization (FVP, *cf.* Voss & Krumwiede, 2010). Therefore, insofar as the style by which the front office instructs the back office on the matter of its necessary role takes on a dogmatic, overly directive quality, the result is an erosion of trust, which in turn leads to "dissonance" in the communication line (Voss & Krumwiede, 2010, p. 4851). Under this condition, the listening party is incapable of understanding the directing party clearly. The erosion of the trust condition may cause straightforward disbelief, inferences that the directing party is merely exaggerating for effect, suspicions about what the directing party is actually seeking to accomplish by its directives, and so forth. The solution to this problem involves strategies that try to open up the lines of communication between the front and back offices, such as by frequently arranging company events wherein they must mix and communicate in relaxed fashion.

On the matter of motivation, the feeling that one lacks support from one's organization will undermine one's enthusiasm for working at all. This lack of enthusiasm will affect how the worker responds to everyone, including how a back-office employee will respond to the front office. Arnett *et al.* (2002) addressed this point, in reference to job satisfaction. Indeed, whatever erodes job satisfaction will cause employees to withhold effort (Herzberg *et al.*, 1959). There is no way to induce more than the minimum motivation necessary to perform the technical functions of the job without first addressing job satisfaction (Hackman & Oldham, 1975).

Therefore, the best approach to mitigating this potential problem is to address the sources of job satisfaction first. Working from Hoppock's (1935) job satisfaction scale, these include satisfaction with coworkers, satisfaction with supervisors, satisfaction with pay, satisfaction with the physical amenities of the workplace, and finally satisfaction with the job in its entirety. Restaurant managers have direct control over some of these sources of satisfaction, while for others, such as pay (which is often very difficult to control, except in high-quality, fine-dining establishments) they must look for creative solutions. Indeed, the solution to any problem over satisfaction with supervisors is the same as that which addresses and FVP condition, namely, good supervisory training, in addition to opportunities for relaxed conversation.

### **Recommendations**

The research conducted supports the fact that the relationship between labor and operating efficiency does have a direct impact on the profitability and ultimate success or failure of the business. Investing in productive, responsible staff is an investment in the success of one's company. However, employees need to recognize the importance of this and buy into the overall philosophies of the company to enable ultimate success. Ongoing training, employee empowerment, and hiring the right people leads to employee loyalty and increased productivity (Hinkin & Tracey, 2000).

The following outlines address some of the vital areas and suggestions to controlling costs. The first outline enumerates recommendations appertaining to labor costs, the second addresses internal marketing, and the last discusses strategy. Table 1, at the end of this list of observations, summarizes these sources of cost-savings.

*HRM*

Here is a list of recommendations that address labor costs through HR practices:

- a) Reducing employee turnover: As noted in the literature review, reducing employee turnover, such as through appropriate incentive policies, will reduce training costs and hence labor costs in general.
- b) Flexible scheduling: This provides benefits by allowing employees freedom in constructing some work responsibilities around their other life priorities. This reduces labor costs by reducing extra work hours, which might occur due to a fixed schedule during low demand.
- c) Part-time employees: These often highly motivated workers cost less, while enabling the firm to avoid the additional cost of employee benefits. This also provides for planned employee turnover and creates a positive training environment, which can benefit one's full-time employees as well.
- d) Cross-training: Cross-trained workers acquire knowledge of other workers' primary functions in this process, typically by pairing employees up at specific times with target tasks that other employees are doing, and assisting the latter with their duties to gain familiarity. This practice is valuable in slower times, when employees may fill multiple functions, while gaining an appreciation for the challenges of their coworkers' responsibilities.

*Internal marketing*

Internal marketing is also important to consider, because smooth interaction among employees reduces waste, while enhancing motivation, as all employees are energetically

engaging in the same larger service. Cost-savings therefore come in the form of reduced confusion about roles and greater motivation to enact them.

- e) **Communication:** Opportunities for relaxed communication are very important, as the discussion at the end of the previous section suggests. Communication must be open and informal, as well as fixed and formal. Formal communication alone is insufficient for real effectiveness on this measure. Exercising an environment where informal communication helps smooth the overall information flow will result in less confusion, which in turn will lead to less wasted time and fewer errors.
- f) **Involvement:** Including employees in company decision making, or at least inviting them to attend discussions about company strategy and finance, is actually very important. The more that the employees understand these issues, the more they will support the entire enterprise. Inevitably, employees will have to make some decisions on their own, even in an environment of low empowerment. Understanding the imperatives of the firm will guide them to make generally productive, rather than costly, decisions.
- g) **Empowerment:** It is important to train employees periodically on making their own decisions at the point of the customer service interface, including (or indeed especially) at the internal customer service interface. To support empowerment programs, managers must also give employees the latitude to make decisions to address unusual situations without having to call on supervisors for approval, except in cases that address company strategies or contractual issues. Empowerment reduces costs by cutting decision cycles, as long as the employees' decision-making error rate remains low. Therefore, good empowerment programs must always have the support of good training in decision-making tactics.

HRM	Reducing turnover	Increasing the employee retention rate through incentive policies and a satisfying work environment reduces costs by building experience, while cutting training time.
	Flexible scheduling	Creatively identifying opportunities for employees to work out coverage of certain service periods (especially low-intensity times) helps to reduce conflicts that may otherwise cause turnover.
	Part-time employees	Part-time employees add flexibility by enabling changes in service coverage as needed. They are also usually exempt from regulatory thresholds for costly benefits.
	Cross-training	When employees learn one another's jobs, they become more adaptable to contingencies, such as last-minute absences or seasonal demand. Any inability to do a needed type of work due to a lack of skill adds cost.
INTERNAL MARKETING	Communication	Both informal discussion and even humor are important for building trust between management and subordinates. Strong trust leads to greater motivation and less waste.
	Involvement	An important part of communication is letting employees attend discussions about company strategy and finance. The more that the employees understand these issues, the more they will support the entire enterprise.
	Empowerment	Training employees to make unilateral judgments helps service quality and saves time by reducing the need to defer special requests or issues to their supervisors.
STRATEGY	Target market	The clientele of a differentiator aims for high quality, but that of a cost leader firm seeks quality consistency, along with value or convenience. Training employees to know the difference cuts costs and enhances customer loyalty.
	Product	A differentiator offers superior product quality and thus uses experienced talent, but a cost leader pursues quality consistency, training workers in exact process guidelines.
	Value chain	A differentiator's value chain starts with the customer and defines all back-office processes, while a cost leader is the opposite. Recruitment and training should conform to this pattern.
	Self-evaluation	Benchmarking against the USAR and wage norms is critical to identifying value chain priorities, including service quality and employee training and recruitment.
	Management	Recruiting strong managers and putting them to the test is essential. A strong manager knows to shop around for cheaper inputs for a cost leader, but to nurture the loyalty of high-quality suppliers for a differentiator.
	Service	Restaurants are focused firms, where one must identify one's theme and train employees to express it as a part of service delivery.

Table 1: Summary of Sources of Labor Cost-Savings

*Strategy*

On the matter of strategy, controlling labor costs comes from recruiting, selecting, and training employees consistently with the restaurant's generic strategy. A differentiated firm, for example, requires employees who have enough expertise to work without constant supervision. By comparison, a cost leader requires a structure that affords a more direct kind of supervisory control and hence more visibility of a workforce that is more likely to include less experienced people. Thus, the following recommendations seem appropriate within the present context:

- h) Target market: Employees must know the firm's target market and what sources of local competition compete for this same market. A differentiated firm's target market looks for product quality overall in the restaurant industry (Porter, 1980). Thus, the firm should try to draw employees from sources of experience in high-quality locations. Because it is cost-effective for a differentiator to pay such employees in market-leading way (*cf.* the nature of the prospector firm; Miles & Snow, 1978), direct recruitment from competitors may often be feasible. The target market of a cost leader, by comparison, will expect consistency in quality and either a low price or some other cost-saving features, such as convenience. However, because the firm must generally pay on a market-lagging scale (*cf.* the defender firm; Miles & Snow, 1978), it should generally train employees closely to achieve that kind of service. Costs will be higher, whether due to inefficiencies in service or due to confusion in the target market itself, if the firm fails to keep this distinction clear (Porter, 1980, 1985).
- i) Product: Product quality is imperative, regardless of the competition. Consistent quality is important for cost leader firms, while superior quality is critical for differentiated firms (Porter, 1980). This suggests the same distinction in employee recruitment and pay scales



as discussed above. Food preparers in differentiated firms must be experts in their fields, or at least highly adept apprentices undergoing the necessary mentorship. Food preparers in cost leader firms should be people trained to follow process detail with great precision. Labor costs will rise if the hiring manager happens to find a superb but expensive chef in the latter case, because the chef's core source of value, namely, her creativity, demands the salary but conflicts with the process demands of the cost leadership enterprise.

- j) Value chain: The value chain of a differentiator begins with the customer and works backward toward sourcing processes (Voss *et al.*, 2010). This means that employees require training to pull the necessary support from the back office, while also being able to make many decisions on their own (*cf.* empowerment, discussed above). In a cost leader, the process starts with the supply chain, where the management must deftly control costs, and moves outward toward the customer. This means that employees require training in adhering closely to process demands, which in essence leaves them to emphasize and deliver available choices to the customer, but with a far narrower ability to tailor the product to customer tastes. This is a cost-effective formula as long as the firm can keep from inadvertently drawing a highly demanding target market to the cost leader. Meanwhile, the differentiator must avoid offering excessive value, such as by cutting prices, when its clientele are expecting quality instead.
- k) Self-evaluation: It is important to assess one's business openly and honestly. This rule includes one's assessment of labor costs, rather than just product inputs. Accordingly, managers should grow accustomed to benchmarking against the USAR (National Restaurant Association, 1996), while keeping up to date with current events and statistics by way of such publications as *Nation's Restaurant News* (*e.g.*, Berta, 2008). Reviewing

industry wage levels through federal agencies will likewise provide information that lets the restaurant manager know what constitutes market-leading and market-lagging levels and can thus apply the correct rule based on the enterprise's generic strategy.

- l) Management: A good manager reviews and evaluates the strengths and weakness of the business, reviews strategies and operational costs, and then updates the marketing strategies. Hiring good managers is very difficult, because the traits of a good manager are difficult to measure (Grote, 1996). Owners should put their managers to a test, preferably a strategic one. Does the prospective manager understand strategy? She should know that a cost leader restaurant should have an active supplier cultivation function in operation, to keep suppliers in implicit competition with one another rather than lose sight of more cost-effective options (Voss *et al.*, 2010). She should also know that a differentiator should nurture strong, loyal relationships with high-quality suppliers, rather than pursue cheaper alternatives as they arise (Voss *et al.*, 2010). Any manager who believes that there is only one way to manage costs in a restaurant is a risky investment for the firm, because the wrong approach will have the opposite effect.
- m) Service: It is helpful to develop unique services, techniques, and attractive qualities about one's restaurant, which other restaurants lack. Training can therefore serve to emphasize how employees can capitalize on these themes and thus draw a more regular complement of loyal customers. All restaurants are to some degree arguably focused firms (*cf.* Porter, 1980). This is because there is usually something unique about a successful restaurant (Parsa *et al.*, 2005). A service may be unique by virtue of its entertainment value, its consistent professionalism, or its family-styled hospitality. If one is discussing an ethnic restaurant, one must understand that ethnically consistent service is critical as well (Parsa

*et al.*, 2005). A Chinese restaurant may grow beyond the point at which Title VII of the Civil Rights Act of 1964, as amended, becomes a statutory criterion (*i.e.*, it attains 15 employees). Suddenly, the managers may no longer hire only Asian workers. However, even though the restaurant must now start hiring anyone who can do the job, without regard to their ethnic appearance, the management may nevertheless dictate the style of clothing, the manner of speaking (and bowing), and how each employee wears his or her hair. Conscientious training in line with the restaurant's theme enhances the experience and therefore leaves the customer with a clearer idea of identity.

### **Conclusion**

To summarize the foregoing study, this paper set out to identify current thinking on the question of what causes labor costs to exceed the grasp of management, as well as how internal marketing might provide some avenues for mitigating this effect. Labor issues are the biggest challenge for most restaurant owners and managers. Effective management is only possible based on the information that one has available. Evaluating productivity and labor costs requires a look at both quantitative and qualitative analysis. Management must keep from losing sight of those factors that are most amenable to simple touch and feel, which involve customer service. When it comes down to it, restaurants are a hospitality business. Hiring employees with good attitudes is an investment in the success of the establishment. Constant training coupled with employee empowerment leads to employee loyalty and increased productivity. Maintaining a competitive edge over the competition, internal marketing, and employee job satisfaction are the links that complete the internal marketing chain.

Job satisfaction is the controlling link in the internal marketing chain, which directly establishes the relationship between labor and operating efficiency and profitability. The

difference between doing a good job and providing great customer service is an employee's attitude and the way that the employee views his coworkers and work environment. Internal marketing is the link that connects the chain (Arnett *et al.*, 2002). Increased competition has many restaurants tightening their belts, doing more with less and considering new strategies and ideas to gain a competitive edge. Employee productivity is as important to the success of the business as the bottom line itself. The quality of products and service is crucial, and often this is the hardest component to measure (Reynolds, 1998). New strategies must start from within. For strategies to be successful, one must have complete buy-in from the staff. Communicating the new strategies, training existing employees in skills that match the new vision, while motivating staff to make changes when necessary, are keys to success. In the event the staff is incapable or unwilling to make necessary changes, one possibly needs to assess one's staffing priorities. When hiring new replacement staff, it is important to try to keep in mind that one needs skilled people, with both strong restaurant knowledge and positive attitudes and values, as these will prove more beneficial over time. It is hard to change someone's attitude, but one can indeed train in attitudinal competencies such as positive interpersonal interaction (Meyer, 2006).

Although this paper discussed mainly the human processes involved in internal marketing and ancillary HR issues, it is important to note that these areas involve constant communication, for which technology remains an important consideration in all contexts. As noted partially in the foregoing recommendations, many food and beverage operations have embraced handheld POS technology as part of their growth strategies. These units help create efficiency by automating the ordering and payment processes. With the use of such POS technologies, servers can fully exploit the advantages of having all necessary information on item availability and detail in the palm of their hand. Today, servers can take and place an order immediately while still at the

table, then move onto the next table without having to go back and forth to the kitchen, and as time passes, the cost of such technology drops. This technology reduces the time it takes for cooks or bartenders to receive orders from servers, which allows guests to receive their orders faster, and servers to focus on delivering excellent service. Technology is certainly making its mark on the restaurant scene. What used to be a tedious, manual process may now benefit from extremely valuable automation, with all of its improved accuracy.

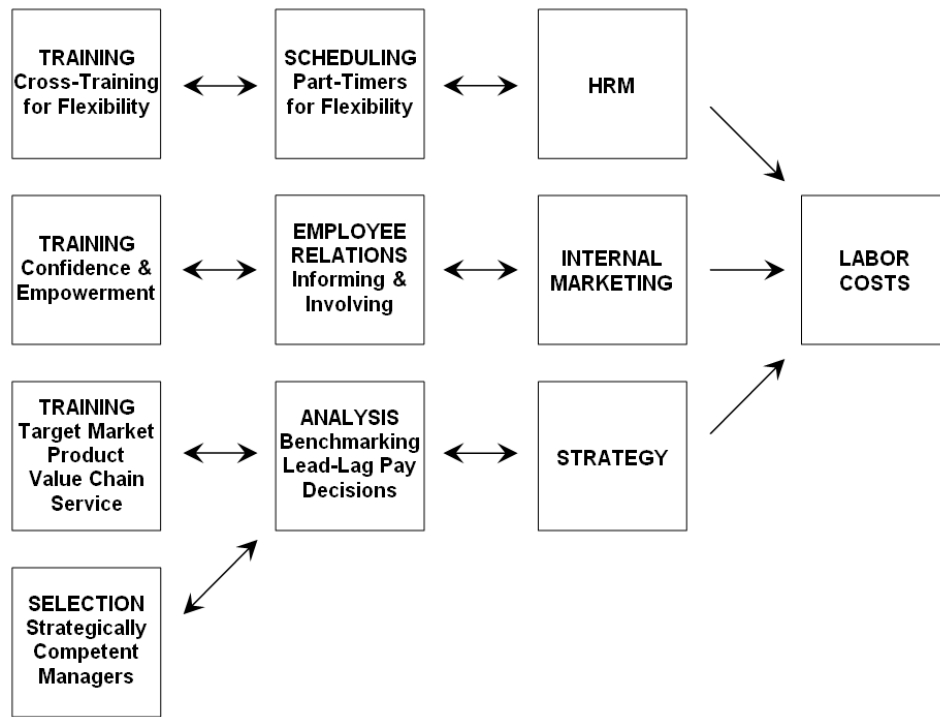


Figure 1: Significant Variables in Managing Labor Costs

(Source: Original)

Although the debates will certainly continue, there is no question that labor costs, in which internal-marketing strategies figure prominently, directly affect operating efficiency and profitability. Whether an owner or a manager, one must be able to be honest with oneself about the actual status of internal marketing at one’s restaurant. Does one’s enterprise suffer from a bias that employees are merely a cost that one must minimize, and inadvertently drive employees

away, due to a perceived lack of concern? Do services excel? Is the product superior? Does one have a unique approach? Has the enterprise adopted a consistent sense of strategic direction, vision, and mission? Would one choose one's establishment over the competition? Does one's establishment stand out above the rest? Has the establishment been doing all that it can to control costs in an informed way that recognizes the value-adding capacity of a motivated workforce?

Future research should address specific questions about how to combine concept with strategy. Although a reader familiar with the literature on strategy will immediately recognize that Parsa *et al.*'s (2005) observation about concept actually supports of a correct apprehension of strategy in restaurant management, the casual reader may instead infer that that failed restaurant owners had thought strategically, while sacrificing the idea of concept. Indeed, the detail of Parsa *et al.*'s (2005) discussion reveals that those failed restaurant owners had an incorrect understanding of strategy. While the study fell short of exploring what these owners actually believed, it would be valid to infer that they saw strategy as an analytical process of performing a SWOT analysis and perhaps constructing a grand-strategy matrix (*cf.* David, 2007). Thinking strategically, in fact, seemed to mean, in their minds, figuring out what customers want and then finding a way to offer it to them, regardless of whether the customer's opinion has anything to do with the theme of the restaurant. A valid strategic idea incorporates the notion of concept in Parsa *et al.*'s (2005) conception, but it seems evident that many people are completely unaware of the need for a coherent, qualitative vision, higher-order strategic orientation (using an available typology such as Porter, 1980; or Miles & Snow, 1978), mission, objectives, and operational strategies.

A restaurant's theme communicates an identity to customers. Referring back to the very definition of hospitality, which seeks to deliver a broader and more personally attuned array of

lifestyle niceties than other service industries, refers to an identity (*cf.* Barrows & Powers, 2009). Why does a customer select a particular hotel? Sometimes the goal is cost-savings, in which case the reference is to a cost leader, the equivalent of which is probably a cafeteria in restaurants. Otherwise, the goal is a personal identification with what the brand seems to offer, the equivalent of which is probably most restaurants in existence. By implication, this means that hardly any restaurants are pure cost leaders without an accompanying focused quality. What is the focus? The answer will be whatever the restaurant is offering that gives the customer his identity when he arrives. A customer's identity is rarely reducible to his appetite.

In the strategic sense, hospitality services perform a highly unusual function, which explains their aim to offer a broader range of personally oriented amenities that would be the case with the simple supply of a product or standard service. According to Voss *et al.* (2010), focused firms aim to cut the customer's implicit transaction price. Pre-transaction focused firms do this by making a product or service available that would have been inaccessible before the firm devised a way to deliver it across the target market's impediment (*e.g.*, geography, time of day, urgency, or accompanying purchase such as gasoline). Meanwhile, post-transaction focused firms do this by providing a product or service that obviates the customer's conceivable need to apply extra work to it in order to make it acceptable. Most pre-transaction focused firms are also focused cost leaders, while most post-transaction focused firms are also focused differentiators (Voss *et al.*, 2010). What is most interesting about hospitality services is the predominance of pre-transaction focused differentiators. However, it makes sense, by virtue of the peculiar nature of hospitality services. Viewed from this strategic model, hospitality services carry an identity close to the person to whom it belongs. For any restaurant that wants to succeed, projecting that identity, rather than merely serving food, is critical for success.

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