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Retail Practice

What's ahead for US restaurants

With indoor dining severely constrained, restaurant operators need to find creative ways to "unbundle" the dining experience and build customer loyalty.

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It's been a start-and-stop recovery for many restaurant operators across the United States. In some areas, restaurants reopened their dining rooms only to close them again weeks later, after a local surge in COVID-19 cases. In this episode of the *McKinsey on Consumer and Retail* podcast, McKinsey's Stacey Haas and John R. Moran—coauthors of two recent articles about the restaurant industry—share their perspectives on what dining out could look like in the "next normal," and the implications for restaurateurs across the country. An edited transcript of their conversation with executive editor Monica Toriello follows.

Podcast transcript

Monica Toriello: Hello and thanks for joining us today. I hope you're listening to this episode either before or after a really great meal. Many people's eating habits have changed dramatically during this pandemic: as we're all painfully aware, restaurants shut down their dining rooms for months, and people started cooking at home more often. Many continue to do so. This year has been devastating for some restaurants—and yet, there are other food-service establishments that have seen their businesses boom since the start of the COVID-19 outbreak.

Today, we'll hear from two McKinsey experts who have recently coauthored articles on what restaurants can and should do during these extraordinary times. Their articles, titled "How restaurants can thrive in the next normal" and "Eating out(side): Restaurant dining in the next normal," are both available on McKinsey.com. I encourage you to read these articles in their entirety; they include some very interesting and informative charts and graphs. And although the focus of this conversation will be the restaurant industry in the United States, many of the lessons and recommendations will apply to restaurants elsewhere in the world as well.

Let's meet our guests. First, we have Stacey Haas, a partner in McKinsey's Detroit office. Stacey is a leader in our Consumer Practice. She's helped not just restaurants but also retailers and consumer-goods companies capture growth through portfolio strategy, innovation, and design. Also with us is John R. Moran, an associate partner in McKinsey's Boston office. John has worked with a range of companies in the food-service value chain, including quick-service restaurants [QSRs], fast-casual chains, convenience stores, and ingredient providers. Welcome, Stacey and John.

Let's start with an easy question. When was the last time you ate at a restaurant?

Stacey Haas: I ate at a restaurant last week. I took all my kids out for dinner because we just had to get out of the house.

John R. Moran: I haven't eaten at a restaurant for six months, since the beginning of the COVID-19 outbreak. But we've done our fair share of drive-through and takeout and delivery, for sure.

The near-term outlook

Monica Toriello: Like you, Stacey, I ate at a restaurant last week—outdoors. And, like you, John, my family has done our fair share of—not drive-through because we don't have a car—but our fair share of pickup and delivery. But it has been an exceedingly difficult year for many restaurant operators. Can each of you give us an overview of what the US restaurant industry looks like right now and what the outlook is for the remainder of 2020?

Stacey Haas: What we're seeing right now is that after the terrible drop in revenue that occurred in March and April of this year, there was a pretty rapid increase in May, June, and July, once a lot of restaurants were able to start opening. But now it has flattened out. It's a huge challenge for a lot of companies—particularly a lot of the smaller and independent restaurants—at the moment.

John R. Moran: Overall, it's certainly the biggest challenge the restaurant industry has ever faced in the US. But the pain really has not been evenly distributed. Just as you said, Monica, certain

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players—like some of the pizza QSRs—have actually been doing great this whole time. Our best estimate right now is that the restaurant industry overall is down about 10 to 15 percent or so. But, of course, that’s an overall average. There are some restaurants doing better and some doing worse. For a lot of the ones doing better, even if they’re down a little bit, they still may be in a sustainable place. They may be in a place where it could make sense to continue operating. Even if their recovery continues to be a little slow, they’ll be OK, versus other places.

Then again, some restaurants, especially in a few places—for example, independent restaurants in urban areas—are doing meaningfully worse than 10 or 15 percent down; it’s still not sustainable. If that persists and if there are further surges, that’s when it becomes really difficult.

Stacey Haas: Our current projections are that restaurant sales will stay relatively flat or slowly increase through the rest of this year. The biggest concern is that we’re starting to see some resurgence of COVID-19 cases in a few states. This is a state-by-state and city-by-city conversation. In Europe, they’re starting to pull back on opening hours again. So, if we end up having something similar here in the US, we could see a little bit of a dip. But thankfully, a lot of restaurants have shown a tremendous amount of innovation. A lot of restaurants, over the past six months, have pivoted toward more carryout, more delivery. So while there are still many challenges, there’s some light for some locations if they have to close down dining rooms again.

How restaurants are innovating

Monica Toriello: Say a bit more about the innovation that you’ve seen from restaurants during this time. Can each of you share a couple of examples of innovations that, perhaps, other restaurants can learn from, or innovations that you think are worth continuing even postpandemic?

Stacey Haas: There’s Lou Malnati’s and their Tastes of Chicago. It’s something they were already doing, where you can get delivery of your favorite foods from a number of different restaurants. It’s both fresh food and things that you can have for cooking at home. It has been a great innovation; Goldbelly has a similar approach.

Another innovation I’ve found—although, it’s not new—is the rate at which people have moved to delivery, to curbside pickup, to carryout, and everything that it takes to make that successful: having your app set up, having the ability to take and receive orders and turn them around, and new packaging to help keep the food warm when it’s leaving the restaurant. My local Mexican restaurant just cut a window out of one of their doors and put a flap over it so that you could walk up and feel comfortable doing a pickup from there in a safe way, without ever having to go into the restaurant.

John R. Moran: A lot of the big chains are making moves that are for the long term as well. They're taking advantage of it and, in some ways, COVID-19 may have pulled forward things that they might have thought about long term anyway. You see some players like Starbucks: they're essentially doing pickup-only locations. So even though Starbucks has long seen itself as a kind of "third place" for people to sit down and enjoy their cups of coffee, this has probably accelerated a trend toward more and more ordering ahead and consuming off premises—now they can have a microlocation that is only oriented toward off-premises consumption.

Taco Bell recently unveiled its "restaurant of the future" idea, with multiple drive-through lanes, again, prioritizing order-ahead pickup. They've actually got one lane for normal live ordering and then another separate lane—a fast lane, if you will—for order-ahead pickup. It's almost like an airport experience, where you have faster and slower speeds of traffic in two different lanes. So that's pretty interesting.

Those are large chains. There are a lot of independents that are having to be very scrappy and incredibly innovative just to get through this. We talked to executives from a sit-down pizza chain a few weeks ago that were saying things along the lines of, "While we're still not getting the dining-room traffic and capacity we want, are there ways that we can bring food to neighborhoods, to cul-de-sacs? We could host a block party for people who aren't getting to socially engage the way they want to, in a safe way. We can bring a ton of pizzas. We can invite everyone. We can get everyone in our neighborhood to sign up together." Maybe there's a new dining model that emerges from that. It's those types of ideas that can sustain restaurants. We'll have to see how much of that is sustainable for the long term.

Monica Toriello: Some of the things you've talked about involve changes to the physical layout of the restaurant and to real estate. Will there be a way for restaurants to survive without touching their real estate? Or do you think that that has to be a big part of their plans for the next normal?

Stacey Haas: We recently did some research with a number of different restaurants. A very high proportion are planning changes to their restaurant layouts for the long term. So we're expecting that—because even if we got to a post-COVID-19 world where people don't have the same level of anxiety about dining in, I think we'll see stickiness of drive-through, stickiness of carryout, stickiness of delivery. That has implications on the size of the indoor space that you need. We already saw that with Starbucks, for example: they've announced pickup-only locations, particularly in high-traffic urban places where they get a lot of foot traffic anyway.

Also, [restaurants will need to make] changes to facilitate delivery, curbside pickup, and carryout—where a customer or a delivery person doesn't have to walk all the way into the restaurant to pick up. The speed at which customers or delivery people can pull in, get what they're looking for, and continue on their routes is going to be really critical, I believe, for long-term stickiness to that brand and ongoing ordering.

Unbundling the restaurant experience

John R. Moran: In a lot of ways, the COVID-19 crisis is really accelerating a trend—you see this in broader retail as well—toward unbundling the restaurant experience. Restaurants have historically always been a place where you go in, you look at the menu, you place your order, the food gets prepared, you dine in, you pay—all on-site, in this box. There's an experience around that, and there's a whole packaging of that experience together.

Those things don't all have to happen together. So, increasingly, you're seeing [experiences that play out in the following manner]: "I'm ordering ahead. I'm paying separately on an app. The food comes to me, or I pick it up in a different way." I think more and more restaurants are seeing that. Of course, delivery has always been around, but it was a small proportion of the experience. Restaurants still largely focused on on-premises dining. I think, for more and more concepts, they do have to think about [on-premises dining] as only one of several different modes that could work.

Stacey Haas: I agree that we'll see an unbundling. We're already seeing an unbundling of the customer experience. That makes it even more important for brands to think about how they'll own that customer experience. What pieces of that customer experience do they have to own, and how do they want to do that differently? Because, as John said, so many pieces are different: the way I order is different, the way I receive my food is different, and the way I'm experiencing dining is different because I'm in my car more than I was before or I'm at home more than I was before.

All of those pieces are crucial for brands to think about: "What do we want that experience to look like now? What pieces do we have to own? How do we create something that's still really powerful for customers and keeps them attached to our brand? How do we still create an experience so that they stay sticky to us?"

John R. Moran: I think there have been too many restaurants in the past that, again, define the primary experience as the in–dining room one, and they consider the drizzle on the plate and everything about the on-premises presentation as core. And then, "OK, we shove it in a plastic thing and put it in a paper bag and the customer can get it off-premises as well," right? That approach is probably not good enough anymore. [Off-premises dining] is going to become such a significant proportion of your business, so as a restaurant, you need to make sure that customers receive their orders, and the food is warm if it's supposed to be warm, it has the proper utensils, it still looks nice, and you're still conveying some of that experience along with it.

You also probably have to think about your menu. Restaurants are increasingly realizing that people don't order sides, appetizers, and desserts as frequently when they're ordering for delivery or for off-premises consumption, and those are oftentimes some of the biggest moneymakers you have. So how do you entice a consumer to still add on those other high-margin items when they're ordering off premises? Thinking about that really carefully is key.

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Partnering with third-party delivery providers

Monica Toriello: With so many people ordering for delivery, do you think it's realistic for a restaurant or a restaurant chain to survive without partnering with an aggregator or a third-party delivery provider?

Stacey Haas: I think it's possible. It comes down to two things: one is the economics, and two is this element of customer experience. [You may not need to involve a third party] if you have enough scale in delivery, which we see with the pizza chains—Domino's doesn't work with third-party delivery players, Papa John's is mostly internal, Panera has got a lot of internal delivery as well—and you've got a number of other large players with scale in their deliveries that have proven they can make the economics work. They're doing it to hold on to the customer experience end to end, in the belief that it is really crucial for the long term.

Do you have enough scale? Can you think about scale in pockets of distance—asking, for example, "Two miles from my restaurant, five miles from my restaurant, where can I get scale?" Or different periods of time during the day: "Can I have enough scale at peak times to be able to do it myself?" I think it's not a one-size-fits-all answer of, "Am I 100 percent with third-party players? Am I 100 percent by myself? Or is there something in the middle?"

But, when it comes to third-party delivery players, there's no doubt that customers are going there. And we are firm believers that you should be where the customer wants to be. But I think the important thing for brands to think about is, what role do they want aggregators to play in their end-to-end customer experience? And if they are partnering with aggregators, how do they still maintain or drive the customer experience that they want?

New ways of engaging customers

Monica Toriello: Even if they partner with aggregators, restaurants can still control some of the digital customer experience, right? One of the things that you recommend in your articles is to "redefine and deepen customer relationships through direct digital communication, loyalty programs, and personalization." Can you give examples of how restaurants are doing that successfully?

Stacey Haas: We've seen some restaurants stand up what we might call a digital war room or a personalization war room. They're actively running a number of different communication-type tests with their customers and doing a lot of different tests on a very rapid basis so they can understand the different ways of engaging with customers that actually energize the customer base, bring them in the most frequently, and ensure they're aware of what the restaurants are offering, including how the menu may have changed and different ways they have of accessing their food. That is, for many, driving tremendous results in terms of customer engagement and also getting customers to try out different channels for acquiring food.

John R. Moran: Just having a robust loyalty program has been one of those strategies that may have been on the back burner pre-COVID-19 and has just absolutely paid off in spades. We looked at Outback Steakhouse, [owned by] Bloomin' Brands, which actually was way ahead of many of its competitors in that they had a relatively rewarding program. They gave meaningful discounts on entrées and they signed up quite a few customers for that. They had, I think, about ten million customers at the outset of the COVID-19 outbreak. And you could have had a lot of debates [about the economics of the program]; there were probably analysts looking at that saying, "Gosh, are we giving away too much? We're giving away a lot of discounted entrées." But that has been a huge lifeline for the company—because the consumer is entirely up for grabs.

Consumers' dining habits have been disrupted. They're looking at new cuisines and new methods of ordering. So when you have ten million members that you can reach out to on a personalized basis and say, "Hey, we're open. Here are our new hours. We're now doing curbside, come back in, do this"—that's gold. Investing in that is huge.

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–John R. Moran

People want to help restaurants, too. So, the more you can reach out to customers on a personalized basis and say, “Support your local restaurant,” the better. A lot of smaller restaurants have been very innovative: “Hey, we’ll help deliver food to first responders or into a hospital.” There’s a great Korean restaurant we order from sometimes, and right in the depths of the COVID-19 outbreak, when cases were really surging and there was a lot of concern about flattening the curve, they said, “Hey, we’re running promotions where we encourage you to order food for hospital workers, doctors, nurses, and first responders, and support your favorite local restaurant that has had to be shut down in the meantime.” It’s that scrappy, entrepreneurial nature that Stacey was talking about that we’ve seen so many independent restaurateurs exhibit—to do good, to help themselves, and to capitalize on the goodwill that consumers feel—because I do think there is a little bit of a sense of, “We’re all in this together.”

The agile restaurant

Monica Toriello: Let’s talk about outdoor dining, which has been a lifeline for many restaurants in the cities where you and I live. But all three of us live in places where, in just a few weeks, it will get cold. What’s your message to restaurant operators as they head into fall and winter?

Stacey Haas: If you haven’t already, you have to be preparing for delivery, carryout, and curbside pickup. Being prepared for that, I think, is going to be the ongoing lifeline. We can see from the research we’ve done that customers have a lot of anxiety about dining in. We could open the doors really wide and still not have the level of dining in that a restaurant would need to survive. So I think it will be dependent on delivery, carryout, and curbside pickup.

John R. Moran: Unfortunately, a lot of restaurants have been in the mindset, say around May or June, of “OK, it’ll be COVID-19 through the summer, but hopefully by the fall or going into the winter, this will have subsided. We can welcome people back in, and the consumer will accept that.” It’s increasingly clear that the COVID-19 crisis is not over. The consumer is still anxious; some of our research points out that 80 percent of consumers still feel medium to high anxiety around dining on premises within the dining hall of a restaurant. A lot of restaurants quickly set up ad hoc curbside pickup for the summer, hoping it would be a six-month solution. But those types of solutions have to last you a lot longer than that. We’re not out of the woods yet, unfortunately.

Monica Toriello: So restaurants will need to continue to be, as you’ve said, entrepreneurial and scrappy and innovative. Stacey, you’ve been writing quite a bit about innovation, specifically in consumer packaged goods [CPG]. Do you think there's anything that restaurants can learn from the process that CPG companies go through to innovate?

Stacey Haas: I actually think it might go the other way. One of the things we spent a lot of time on with CPG companies is how to be more agile: to ideate quickly but then get out and test and learn from consumers. And that's throughout the development process, putting the product into markets, seeing what kind of feedback you get, and revising. Actually, I think a lot of restaurants have done this fantastically well.

One of the things we've heard is that in the past you would have a really lengthy development process, you might debate for a long time, and you might do a ton of consumer research to figure out whether customers are going to like it or not. But now, restaurants have had to move; they've had to do things differently. And that sense of risk has gone in a different direction. The risk of not doing something different has been greater than the risk of trying something that isn't successful or that you need to adjust.

I've been thinking a lot about how to keep that agile approach and that mindset of trying things when we get back into a world where the balance of risk may feel different again. Customers have been quite adaptable during this time period, so I really want to keep that agile approach to innovation even after this time period.

'People want to dine out'

Monica Toriello: As you both said, it looks like restaurants are going to have to be agile for a while longer. The statistics from the National Restaurant Association have been very sobering: more than 100,000 restaurants closed since March, $185 billion in losses so far, massive layoffs across the industry. Amid all this, are there any data points, or maybe "anecdata," that you think paint a more positive and hopeful picture of the industry and its future?

John R. Moran: For me, the most positive data point is that the consumer still wants to dine out. There's a world you could have foreseen in which people feel like, "Gosh, COVID-19, the economic fallout, and the uncertainty of so many consumers—it's all going to shift toward people dining at home and shopping for groceries and cooking for themselves." But people want to dine out—Americans, more than almost anyone else in the world. I was driving on the highway the other day and the drive-through lane at Wendy's was literally backing out onto the highway. It was almost dangerous; it was ten cars deep.

People want to dine out—and they're always going to want to. Even if the independent-restaurant segment is hard hit, I have no doubt that, in the future, longer term, people will come back. These are not lost behaviors; this is not a lost generation here. So, it's extremely difficult at the moment, but consumers are going to be there if we can accommodate them.

"Ingenuity and effort from restaurants have been able to sustain people during these challenging times."

–Stacey Haas

Stacey Haas: I'm constantly reading stories about the owners of a lot of these independent restaurants and the lengths that they've gone to in order to serve their customers and to keep as many workers employed. The flexibility they've shown and the resilience they have is part of what gives me hope that they'll survive and that they're doing everything that they can—not just to survive but also to help the whole ecosystem to eventually thrive again. I was thinking about the restaurants in New York. The restaurant industry in the city has been very hard hit.

But then you see these pictures of all the outdoor dining that got set up on the sidewalks, in the streets, in parking lots, in parks—sort of anywhere and everywhere—and the joy that comes from people being able to be outside and experience the tremendous food culture that exists in that city. And I think the same has been true in many other cities. Because food is a cultural experience; it is so core to the way that we interact with others and come together. Those have been my favorite stories. Work and ingenuity and effort from the restaurants have been able to sustain people during these challenging times.

Monica Toriello: I totally agree. I live in Manhattan, and I was walking around yesterday, and there are streets where it's almost like a party atmosphere—tons of people eating outside. You're right, people do want to eat out; people want to patronize restaurants. My last question for you: If a restaurant operator comes to you and says, "I want my business to make it through this. I'm overwhelmed and worried and anxious but I want to make it work. What do I need to do?" What do you tell that restaurant operator?

Stacey Haas: If a restaurant is going to make it work in the short, medium, and potentially even long term, it'll be about reassessing the channels where you meet customers and making sure that you can engage with them in the ways that they're comfortable with. So whether it's in your restaurants, or it's delivery, carryout, or curbside pickup—figuring out that flexible model that allows you to meet customers where they're at, but with economics that can work for you, is the most crucial thing right now.

John R. Moran: The way out will be through the consumer. The consumer is in a very different place, and we're having to operate with very different models. But if you keep the consumers, the guests, front and foremost in your mind—even if they may not be able to dine in the restaurant, even if they may have significant anxiety—and you think about what their experience is going to be like, what they want to eat, and what they're willing to pay for it, and just continue to optimize around that, that's going to be the way out of the woods.

Monica Toriello: Hopefully, we'll do a follow-up to this podcast next year and the industry will be in a much different—much better—place than it is today. Thank you, Stacey and John, for spending time with us, and thanks to all our listeners. Join us again in a few weeks for the next episode of the *McKinsey on Consumer and Retail* podcast.

Stacey Haas is a partner in McKinsey's Detroit office, and **John R. Moran** is an associate partner in the Boston office. **Monica Toriello** is an executive editor in the New York office.

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