

Management Matters

food for thought

Should food and beverage service on trains be a source of revenue in its own right? Or should it just be viewed as part of a wider package?

food and beverage (F&B) service on passenger trains is an integral part of the service that passengers buy when purchasing tickets. It is just one of many elements – like toilets, lighting, well-maintained equipment, and on-time performance – that are important in selling the volume of tickets needed to achieve economic operation.

Generating sufficient volume depends on offering a service that will attract a large number of people who have other transportation options – ‘discretionary’ travellers. Minimalist, low-quality service designed only to meet the basic needs of those who have no other transportation options will not generate the volume and revenue required to achieve reasonable fare-box recovery levels – or serve the broader public purpose of encouraging people to leave their cars at home.

For example, studies claiming that Amtrak’s lounge and dining car services ‘lose’ money make the mistake of analysing them as restaurants. That’s the wrong business model. The correct model can be found in the hospitality industry – bed and breakfast operations and that part of the hotel industry that has followed their lead. Operators provide food and beverages free of charge. While this strategy would put any restaurant out of business quickly, it makes economic sense in the hospitality industry because food and beverage service helps sell something of greater value – rooms. Similarly, in the passenger train business, lounge and dining car service helps sell something of greater value – tickets.

Amtrak provides food and beverage service on all but four short distance routes. Its F&B services range from full dining car and lounge service on overnight trains to lounge, café, dinette or snack cart service on day trains – including 10 that are shorter than 200 miles.

Amtrak’s annual ‘net cost’ of providing this service (the portion of total cost not covered by sales revenue) was approximately US\$109 million in both FY2004 and FY2005. For perspective, this net cost represented less than 4% of the total cost of operating Amtrak’s national passenger train system.

Ticket revenue in FY2005 exceeded the net cost of food and beverage service by more than 11 times. If the availability of food and beverage service caused just 9% of passengers to choose the train instead of driving or flying, then the additional ticket revenue generated by food and beverage paid for its net cost. Alternatively, if the elimination of food and beverage service caused 9% or more passengers not to buy train tickets, but use other modes, the revenue lost would more than offset any savings that would be gained by eliminating this important amenity. The result: fare-box recovery would fall and the taxpayer cost of providing the service would rise – even though the system was carrying fewer passengers. Spending more to accomplish less is always a bad outcome.



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The longer passengers spend on the train, the more important lounge and dining car service becomes to them.

Moreover, the longer passengers spend on the train, the more important lounge and dining car service becomes to them. Even the US DOT Inspector General, in his controversial critique of Amtrak's food and beverage operations, acknowledged that "...passengers travelling on long distance trains for 10 to 12 hours or longer clearly need a means to access food during the trip..." The inescapable conclusion is that the elimination – or downgrading – of food and beverage service would have a disproportionately negative impact on Amtrak's highest value customers – those paying higher fares to make longer trips.

When analysed in terms of its impact on ticket revenue – not as a stand alone profit centre – food and beverage service on most, if not all, trains generates more in revenue than it costs to provide. In other words, food and beverage service is incrementally profitable. It satisfies the two requirements that the US DOT Inspector General set forth in his report: that food and beverage service be provided "at no net cost to the taxpayer" and have "a positive effective on net cash flow".

The importance of this amenity to the high value customer is confirmed by the fact that F&B sales per passenger increases with trip length. When comparing F&B sales per passenger with average distance travelled for each of Amtrak's routes, we found that, on average, F&B sales per

passenger increased by approximately US\$2.00 for each 100 miles trip length increased.

In addition to trip length, two other factors contribute to increased F&B sales. One is including food in the ticket price. Auto Train includes food for all passengers in the ticket price and has the highest F&B sales both per passenger and per passenger mile. The NEC High Speed service (Acela and Metroliner) includes food in the fare for first-class passengers and has the second highest F&B sales per passenger mile.

A second factor is the amount of emphasis on F&B service and the promotional effort put behind it. On the West Coast corridor services – where states influence service standards and emphasise F&B service as an important amenity – F&B sales per passenger mile are 2.2 times higher than they are on the NEC regional trains.

While essential for longer trips, F&B service is also an important tool in selling tickets for shorter trips.

On Acela – the premium high-speed service between Washington, New York and Boston – F&B sales per passenger mile (which adjusts for differences in trip length) are almost three times more than on the NEC Regional trains, despite the fact the average trip on Acela is only 176 miles long and the train is fast.

There are three important ways to control the net cost of passenger train food and beverage service.

The first is with

increased sales volume.

Higher sales will drive positive economies of scale.

Increasing sales volume will increase this gross profit and help cover a larger portion of the fixed costs. The fact that F&B sales per passenger mile on West Coast corridor trains are more than double the level on NEC regional trains suggests the potential that expanded service hours, adequate stocking and aggressive marketing have to increase sales volume and reduce costs.

The second is competitive pricing. Pressure to eliminate F&B losses has caused Amtrak to push prices to levels that discourage sales. When food is included in the fare, prices are not important to passengers. Higher prices don't cause any additional expense. For Amtrak, they simply result in a larger portion of ticket revenue being allocated to F&B service – an accounting transfer that has

no impact on the bottom line. It's when food is not included in the fare that prices become important.

For the passenger, food and drink represent extra out of pocket expense. Customer knowledge of what is 'normal' in the market creates expectations of what is 'reasonable' and limits Amtrak's ability to raise prices without creating ill will. For Amtrak, these cash sales represent additional revenue, 57% of which drops through to the bottom line. The goal in setting prices should not be to extort the maximum amount possible, but to encourage purchases by more people more often. Prices that are in line with passengers' expectations will support strategies designed to increase sales with aggressive promotion and expanded service hours.

The third method is to increase labour productivity. Labour is the largest cost in providing F&B service. It accounted for 61% of total F&B cost in FY2005. Increasing labour productivity is a critical part of controlling the 'net cost' of F&B service. Amtrak is implementing significant changes in its food operations that should increase sales per labour hour significantly.

Amtrak has recently revamped the complimentary first-class Acela express menu.

Now passengers can choose from omelettes – Southwest, Tuscan, Mediterranean or three-pepper – and French toast or Belgian waffles, each with a fruit compote for breakfast, and pesto chicken or seared salmon with an assortment of vegetables for dinner. Snacks like Genoa salami, mozzarella cheese, artichoke quarter and green and black olives served with crackers are also served. Lunch fare also includes fresh sandwiches and a variety of entrée salads and soup.

A rotating selection of complimentary red and white wines is available by the glass. The new series of Fall/Winter menus is comprised of four-week cycles to ensure that frequent travellers experience a broad variety of meals and wines.

For Business Class, some Acela Express trains now feature at-seat cart service. A selection of snacks and beverages are available for purchase from the cart, so passengers do not have to make a trip to the café car.

Food and beverage director Pete Humphreys says: **"Our passengers and employees told us clearly that they wanted to see the Acela first-class meal service returned to its previous levels that distinguished the service in the early days of Acela's introduction..."** Amtrak is pleased to once again offer an enhanced dining experience, which better reflects the first-rate service expected on Amtrak's flagship train."



Acela also had the largest F&B net cost in absolute dollars of any Amtrak route in FY2004. The net cost of F&B service on Acela – although large in terms of total dollars – represented only 4% of ticket revenue.

On the West Coast, the Capitol Corridor service between San Jose, Oakland, Sacramento and Auburn, California has the shortest average trip of any Amtrak route: 68 miles. Eugene Skoropowski, managing director of the Capitol Corridor Joint Powers Authority, says, "The availability of food and beverages is one of the reasons our trains are attracting a growing number of riders. That's why we offer this service on every train we operate along the 170 mile Capitol Corridor."

Pleasing passengers sells tickets. Patronage on the Capitol Corridor trains has tripled in the last six years and continues growing. Although food service costs roughly US\$1.6 million more to provide than it takes in each year, Skoropowski considers it as a cost of doing business, just like well-maintained equipment, on-time performance and clean bathrooms. "Our objective is to give passengers the services they want. We strive to control the net cost of F&B service, not to make a profit. Last year, the net cost of food and beverage service amounted to only about 5% of the total cost of the service. Ticket sales would drop more than that if we eliminated the service. Financially, we're better off with food service than without it. In terms of its impact on our overall fare-box recovery, F&B is a major, positive contributing factor."

Conclusion

The provision of food and beverage service on intercity passenger trains is an essential and integral component of attracting passengers and selling tickets. While charging passengers additional amounts for food and beverages can defray part of the cost of providing this service, food and beverage service is not a standalone profit centre – any more than toilets and other on-board amenities are. It is just one of many costs of operating passenger trains.

We have cited the hospitality industry as one example where rational businessmen deliberately 'lose' money providing food to their customers in order to sell a product of higher value. We could just as easily have cited hospitals, nursing homes, cruise ships or airlines operating long distance flights where food and drink are included in the base price of the service – without any extra charges to defray the cost.

It is never possible to get the right answer when you ask the wrong question. Critics who argue that food and beverage service on passenger trains should be a profit centre are asking the wrong question and getting the wrong answer. The right question is how to manage the net cost of the service. The right answer is by increasing sales volume and improving labour productivity. The focus should be on actions that sell more tickets, raise total revenue and improve an operator's economic efficiency and fare-box recovery. ➤

