

BAKERY TOOLKIT

How To Manage Your Business Through A Tough Economy

The Donut Issue:

Taking the Retail Donut Business to New Heights



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Driving the Donut Business

A retail bakery owner recently shared this interesting thought: “My decorated cakes are the icing, but donuts pay the rent.”

The point here is that sometimes our industry can forget that everyday items like donuts are what drive people into retail bakery shops in the first place.

You depend on drawing-card items to turn your bakery into a destination for party planners, graduations, weddings and other special events. But equally important are fresh bakery products that bring in traffic every day of the week. Donuts pay the rent.

In this second edition of *Bakery Toolkit*, we examine the pivotal driving forces in today’s retail donut business and offer important business tools to manage and maximize profitability.

We include a look into ways to improve your understanding of pricing mechanisms, so that you can find better ways to sell your donuts at levels that ensure you are getting the value of what they are worth to the marketplace.

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For many years, retail donut shops sold donuts for below 50 cents apiece. Now that the stakes are higher, are you getting what your fresh products are worth to the marketplace?

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Pricing: Maximize Profitability

How many times have you heard a fellow baker comment: “I was afraid to raise my prices, but once I did, a lot fewer customers complained than I expected.” If this sounds familiar, you are not alone. But what have you done lately to test your own pricing strategies and find out whether you are at the right levels?

Top Pot donuts sell for \$1.25 or more at Starbucks locations across the country.



For many years, retail donut shops sold donuts for below 50 cents apiece. Now, depending on where you operate, the norm for glazed yeast donuts ranges from 55 cents to 75 cents. Prices at Voodoo Donuts in Portland, OR, start at 95 cents apiece. In New York City, Doughnut Plant sells glazed cake donuts for \$1.75 each and glazed yeast donuts for \$2.25 each.

Starbucks is proving that everyday consumers will pay \$1.25 or more for one donut (the world’s No. 1 coffee seller is supplied nationally by Seattle-based Top Pot Doughnuts). So how do you stack up?

First, you need to understand the realities of your marketplace. What is your competition, and at what levels do they price their donuts? What is the competition’s quality image compared to yours? Chances are, you undervalue your own quality image and have yet to reach the upper

limit of what you can effectively charge for your donuts, even in this economy.

> PRICING FUNDAMENTALS

For starters, the process of evaluating your pricing strategies begins with a thorough analysis of where you are and where you want to be. It is important to understand, first and foremost, that consumers associate quality with price. Numerous studies have shown consumers perceive products with the lowest price as also being the lowest quality. So if you are trying to gain an edge on your competition on the basis of price, you will quickly find yourself in a losing battle.

Instead, you stand to gain tremendous benefits by testing the upper limits of your prices. If you raise your price by X percent, you may not sell as many donuts, but you will make more money. In fact, it is not always a foregone conclusion that you will sell fewer donuts, even at the higher price. Bakers often discover their unit sales go up slightly after they raise their price because consumers perceive the higher-priced donut to be higher quality. One baker in Ohio recently doubled his sales of a signature donut after raising the price by 10 cents apiece. Call it the Cadillac effect; people are more willing to pay a premium for a premium quality donut like yours.

> FINISHING TOUCHES

Another important factor to consider is presentation. Any bakery can take a 60-cent donut and turn it into a \$1 donut with a little ingenuity. Top Pot Doughnuts, for example, uses the term “hand-

FAST FACT

One baker recently doubled his sales of a signature item after raising the price of the donut by 10 cents apiece.

forged” to describe its donuts in marketing messages to customers, giving their product a special allure. That translates into higher perceived value.

In addition, an increasing number of retail donut shops are devoting more time and resources to donut finishing. Creativity can go a long way toward raising your customers’ perceptions of your bakery’s quality image. Thus, spending more time on donut finishing can lead to bigger payoffs for you.

Similar to what is happening with high-end cupcakes in America, consumers all across the country are demonstrating a willingness to pay more than \$2 apiece for a donut that is truly unique. You can achieve this by using icings, donut sugars, and decorations that add customer appeal. Equally important is the look of your finished donuts. Is your donut glaze dull or too thin? Those are variables you can control with a little extra attention to detail. The bottom line is, by spending more time on finishing, your customers will spend more on your donuts.

Production: Be More Efficient

“Time to make the donuts.” For bakers who recall the 1983 Dunkin’ Donuts commercial that popularized this famous line, the words may conjure up feelings of drudgery. Donut production, after all, is hard work. You wake up early in the morning to make donuts and spend the rest of the day selling them. Then you

Donut shops can benefit by matching up what production methods they use to the demands of their marketplace.



start all over again the next day.

Yet as times have changed, so has the donut business. Consumers buy donuts more often throughout the day, not just in the morning. And young adults have made the donut a favorite after-midnight snack in college towns across the country.

What’s more, donut shops have a variety of production methods to choose from—donut base, donut mix, frozen dough, or pre-fried frozen. The majority of donut retailers use bases or mixes, but increasing numbers of retailers will try frozen products on weekends or as late-day substitutes.

The key questions to ask are: Which production method suits your needs the best, and does your situation vary throughout the day or week? The answers depend on your specific goals and what your purpose is in the marketplace.

> IMPROVE YOUR EFFICIENCY

As a retail shop, you need to be efficient to remain profitable. So it is important to evaluate your production methods to make sure you are running your bakery as efficiently as possible. One area to examine is the production cycle for your high-volume and niche items.

First, think about the product portfolio you are offering customers, and make sure that you are devoting the most production time to the items that are most important to the success of your operation. If you are spending as much or more time producing a niche item as a high-volume item, then you need to re-evaluate your production methods.

As one example, you can make life easier by bringing in various types and flavors of donuts in ready-to-finish or ready-to-sell form, freeing up your production time and equipment to produce more of your own signature donuts. That way, your bakery can offer the wide variety that customers today demand while, at the same time, devote more resources to produce and finish the top-selling donuts that your bakery is known for.

You can even use frozen product to keep extra inventories on hand for those occasions when you might run out of certain types or flavors of donuts in the late afternoon or at night.

Still, when you bring in frozen product, you also must consider how much freezer space you have on hand to ensure that you can stock what you need.

FAST FACT

A growing number of retail bakeries report they would consider buying more frozen product to make their life easier.

> MANAGE YOUR IMAGE

Regardless of what your competition does, it is imperative that you maintain and manage a high-quality image to stay ahead.

“To us, the quality of our donuts is what matters the most,” says Polo Garcia, store manager of Round Rock Donuts. “We’re selling more of everything. We open at 4 a.m. every day, and people buy donuts all day long.”

Austin-based Round Rock Donuts opened in 1926 and offers regular, chocolate and cake donuts (in four flavors) for 55 cents apiece and sells up to 200 dozen on a busy day. Their yeast donuts feature a distinct yellow color, which the donut shop chalks up to using fresh eggs.

So when it’s time to make the donuts, take a lesson from retail bakeries like Round Rock and keep a sharp eye on the quality of your finished products. Recognize your role in your local marketplace and then match your donut production methods to what suits you and your customers the best.

Branding: Tap into Celebrations

One of the best ways to leverage your donut brand recognition is to tap into special celebrations throughout the year. For example, Krispy Kreme Doughnuts, Inc. celebrated National Doughnut Day on Friday, June 5, when participating Krispy Kreme stores gave away a free donut to all customers. The 520-store chain

Krispy Kreme's new mini donuts appeal to customers who are looking for quick and affordable options.



leveraged the timing of the promotion to invite customers to join “Friends of Krispy Kreme” at www.krispykreme.com to discover future discounts and events.

This offers a prime example of how any retail bakery can tie in promotions to your own website and enhance your brand image with loyal customers. National chains like Krispy Kreme provide an effective case study on different types of promotional events that spark greater customer interest and boost your overall sales and profitability.

Attempting to drive new sales in the national donut business, Krispy Kreme launched a major promotion earlier this year to coincide with the introduction of its new “Mini Doughnuts.” These new donuts are half the size of original Krispy Kreme donuts and are available in three flavors: Signature Original Glazed, Chocolate Iced rings and Chocolate Iced rings with sprinkles.

The major promotion involves a sweepstakes in which the grand-prize winner will win a brand-new 2009 MINI Cooper. From April 27 through May 31, customers could enter to win by receiving an entry code with any mini donut purchase at participating Krispy Kreme stores, or they could register online. Krispy Kreme's new mini treats are designed to add to any party or gathering with family or friends. "Our new mini donuts are small, and irresistible," says Ron Rupocinski, executive chef for Krispy Kreme.

> FUN WITH FLAVORS

Another effective promotion for donut shops involves the introduction of any new donut flavor to your lineup. Don't just add a flavor. Make an event out of the introduction, and invite your customers to celebrate.

This spring, LaMar's Donuts brought back a popular favorite called the Citrus Burst, which the company calls a glazed donut that comes with bits of lemon and orange flavoring. The new flavor was available in select LaMar's stores through the month of April. First offered four years ago, the specially flavored donuts sold out in a number of locations during their debut in 2005.

"We first developed the Citrus Burst as a one-time, seasonal salute to spring," says Anthony Bonelli, CEO of LaMar's, a chain of 30 donuts shops in six states. "But customers still ask for them to this day, so we thought it a great idea to bring them back for a celebration of spring in 2009."

FAST FACT

National Donut Day is celebrated every year on the first Friday of the month of June.

Dunkin' Donuts' new "Create Dunkin's Next Donut" contest attracted nearly 130,000 donut contest creations submitted online. In May, the national chain announced 12 finalists who will compete for the chance to win a \$12,000 grand prize and have their winning donut sold in participating Dunkin' Donuts locations. Finalists include:

- "A Nutter One" — A chocolate "butter kreme-filled" donut with peanut butter icing and chopped Reese's Peanut Butter Cups (Carol D'Angio, Palm Beach Gardens, FL)
- "Bodacious Banana" — A Bananas Foster-filled donut with chocolate icing topped with shredded coconut (Christine Roman, Ellenville, NY)
- "Chocolate Monkey" — A Bananas Foster-filled donut with chocolate icing topped with Hershey's Milk Chocolate shavings (Michelle Ventura, Cranston, RI)
- "Economic Crunch" — A cake donut with chocolate icing topped with graham cracker crunch and butternut crunch (Michael McNeil, Aliso Viejo, CA)

Economy: Demand for Comfort

Randy's Donuts in Los Angeles is not unlike a lot of donut shops, except for the occasional Hollywood movie crew that shows up to film a few scenes next to the Southern California landmark's 32.5-foot donut on top of their store. Otherwise, donut sales here remain solid, and consumers are still looking for bargains and "comfort" foods.

The economy isn't hurting donut sales, according to bakers who agree consumers crave the comfort of donuts.



Randy's co-owner Ron Weintraub says their donut sales have not dipped a bit, despite the economic slowdown over the past year. In fact, a wide number of popular donut shops like Randy's report that donuts are one of the first foods consumers gravitate toward when times are tough.

"It's a lot cheaper to feed four people with a dozen donuts than it is for a family of four to go out to a restaurant for breakfast," Weintraub points out.

What is apparent on a national scale is that a number of retail bakery shops are closing, not because donut demand is down, but because the economy is taking its toll on small businesses on the whole.

Full-line shops like Rick's Bakery in northwest Arkansas notice that some area donut shops have gone out of business, but Rick's is selling more donuts than a year ago, es-

pecially traditional glazed. “I think as the economy gets weaker, donut business gets stronger,” owner Rick Boone says.

“It’s a comfort food. And you know you can walk in for a dollar and basically get something to eat. Or for a dollar and a half, you can get a donut and a cup of coffee and feel like you’ve kind of treated yourself a little bit.”

> BREAKFAST BOOM

One place for donut shops to look for new business opportunities can be found in the breakfast category. A recent study by food-service consulting firm Technomic revealed bakery cafés are gaining in popularity as a breakfast destination, with nearly 2 in 10 respondents indicating that they most recently visited a bakery cafe for breakfast.

In addition to donuts and other baked goods, Fayetteville-based Rick’s Bakery sells sausage rolls that they bake in their own ovens, giving the hand-held food a distinctive flavorful taste. “We have what we call a ‘pig in the blanket’ that’s really our number-one seller in the whole bakery, as far as volume units,” Boone says. “We basically have one full-time person that that’s all they do. We kind of started that on a fluke about 15 years ago, and it’s kind of become one of our signature items. It’s a sausage and cheese wrapped up into one of our breads.” Other bakeries are embracing this trend by offering cheese- or fruit-filled *kolaches* (a popular item in central Texas where there are large Czech populations) and sausage rolls. Kountry Bakery in Hallettsville, TX, bakes more than a dozen kinds of *kolaches* in flavors

FAST FACT

Americans consume more than 10 billion donuts annually, and U.S. retail donut sales are estimated at \$3.6 billion a year.

ranging from peach to pan sausage & cheese. In such cases, bakeries can make use of equipment they already have and don’t have to add expensive labor.

> CONVENIENCE OPPORTUNITIES

Donuts also continue to be strong sellers at convenience stores, which can get their donuts from a local bakery or a central commissary. Prominent convenience store operators like 7-Eleven are offering more choices of fresh bakery items, including donuts. According to the National Association of Convenience Stores, prime opportunities exist for fresh bakery and packaged sweet snacks, a category that has seen average gross margins per store climb in recent years.

Another key consumer indicator that bodes well for the donut industry is that demand remains high for fried foods, according to a 2009 Technomic study. Nearly 90 percent of consumers associate fried foods with being “tasty” and “satisfying.” Donut shops are wise to promote such attributes to their customers who are looking for great taste.

Merchandising: SKU Control

More than 40 flavors of donuts dot the menu at Sweetwater's Donut Mill in Kalamazoo, MI, including such unique choices as Chocolate Covered Cherries or Caramel Apple. Likewise, the Fractured Prune Donut Shoppe in Rockville, MD, features originals like the Peppermint Patty (mint and mini chips) or

Offering a distinctive choice of donut varieties is important. But try to avoid going too far or risk cutting into your profits.



Pebble Beach (glaze, cinnamon & sugar, and mini chips).

These bakeries offer great examples of how originality can set your donut shop apart. After all, one key competitive advantage for any independent retail bakery is that you can think of an idea today and have it on the shelf tomorrow.

But before you get ahead of yourself by offering every variety under the sun, remember the importance of SKU (stock-keeping units) management: To remain profitable as a bakery business, you must think of yourself as the landlord and every single one of your products as tenants. Each tenant must pay their own rent. And if they don't pay the rent, sometimes you have to evict them.

The lesson here is that any donut shop must effectively manage the number of varieties they produce through the continual analysis

of sales and trend data. The slippery slope is that your customers will always want more variety, but you have to know exactly how much variety you can afford to give them. Otherwise, you may go out of business.

A number of retail bakeries achieve successful SKU control by running the numbers from their point-of-sale systems on a weekly, monthly and annual basis. Then they do comparable sales analysis to compare how each product is performing from one period to the next. It's important to establish a threshold for when sales of any item drops off by X percentage, then it is time to remove that SKU from your menu.

Even if you don't have a point-of-sale computer system, you can still do this type of analysis by monitoring what you produce and what you sell—down to the specific variety. You need to know how much it costs you to make every variety of donut, and how many of each variety you sell on a weekly or monthly basis.

With so much on the line nowadays in the bakery business, doing the math is as important as making a great-tasting donut.

> COMPARATIVE ANALYSIS

To further help you understand key trends that are occurring in the donut business, the following information is from a 2008 Dawn White Paper report that analyzes donut category management in the supermarket bakery, based on Perishables Group data. This report can help you do comparative analysis on how your donut business stacks up against the norm.

FAST FACT

Donut sales reach their peak as the weather starts to cool off during the month of October. Another big sales month is February.

In 2008, assorted/variety bulk donuts made up 43.9 percent of donut sales at U.S. supermarket bakeries, followed by yeast donuts at 31.6 percent, gem/mini/donut holes at 11 percent, cake donuts at 7.6 percent, and filled donuts at 5.6 percent.

In 2008, dollar sales in assorted/variety bulk donuts grew by 5 percent, as did the dollar growth in cake donuts (4.6 percent) and gem/mini/donut holes (2.2 percent). Donut subcategories with declining sales included filled donuts (down 9.3 percent), and yeast donuts (down 7.4 percent). The top week for donut sales was the week of Mardi Gras/Fat Tuesday, with an average of \$793 per store—this is driven by filled donuts, such as paczki donuts.

For fillings, the dominant flavor is raspberry, capturing 55.1 percent of filled donut dollar sales. White cream comprised 20.9 percent of filled donut dollar sales, followed by assorted fillings at 5.7 percent, Bavarian cream at 5.5 percent, jelly at 3.6 percent, chocolate cream at 3.4 percent, and apple filling at 1.9 percent.

Front Lines: Sales Drivers

So what is driving sales right now in the retail donut business? We asked donut shops across the country to share their views of what is happening with consumer buying habits and what factors they believe are playing most heavily into the equation.

Rick Boone, owner of Rick's Bakery in Fayetteville, AR, says one trend is clear:

Adding more flavors within top-selling donut categories is one key sales driver today.



Donut shoppers are looking for value.

“We’re seeing more, larger orders going out,” Boone says. “There are more people buying dozens now than they were. You can buy a box of donuts cheaper than you can buy a box of Danish or cookies or things like that.”

Ron Weintraub, co-owner of Randy’s Donuts in Los Angeles, agrees that people are looking for more bargains, and donuts fit the bill because they “are relatively inexpensive.” Generally, their customers want to keep it simple. “Traditional glazed are still our most popular donut,” Weintraub says.

By comparison, Rick’s Bakery is putting a new twist on top-selling items by leveraging their popularity with new flavors within the subcategory.

“We’re taking what we call our ‘larger items’—our cinnamon rolls, apple

fritters, long johns, any thing other than the rings—and we're trying to increase the variety of them," Boone says. "So like with a fritter, we have a blueberry fritter, a triple-berry fritter, an apple fritter and a raspberry fritter. So we're trying to take each product that really sells and kind of build from that and give people different variation options."

According to new research by The Food Channel, international and unusual flavors are one of the top 10 trends for the dessert business in 2009, and the donut industry can borrow a lesson from that idea. Other top 10 trends include nostalgia (think grandmother's recipe) and portability.

Doughnut Plant, a one-store shop in New York City, recently introduced a tres leches donut that is filled with a mixture of three sweet creams. This filling is similar to what's inside tres leches cakes, which are widely popular with Hispanic consumers.

Convenience also plays a huge role in the donut business, as consumers continue to live hectic lives, with one hand on the steering wheel and the other holding a donut for breakfast.

Located in the Austin suburb of Round Rock, TX, Round Rock Donuts sells a high volume of donuts through the drive-through window. The percentage continues to grow, says store manager Polo Garcia, as people continue to eat more on the go. "We probably sell 35 to 40 percent through the drive-through," he says. Fast-food chains like McDonald's

FAST FACT

Three of Food Channel's Top 10 Trends for 2009 are nostalgia, portability and unusual flavors.

do half or more of sales through the drive-through, so expect this trend to grow.

> THE PORTABILITY FACTOR

With dashboard dining on the rise, donuts figure favorably in the eating habits of American consumers. Donuts continue to be a great single-serve food choice for consumers looking for value and great taste throughout the day.

Doughnut Plant in New York City serves constant waves of customers from early and late morning to shortly after the workday ends in the late afternoon for many New Yorkers. Saturday morning is another strong day for sales, as consumers stop in for boxes of donuts for picnics in the park or drives to the country.

In places like Los Angeles, donuts are even more popular. There is a proliferation of donut shops dotting the many streets and highways. To keep pace with all that traffic, Randy's Donuts opened a drive-through window in 1950, which is considered to be one of the first donut drive-throughs in America. And still to this day, drive-through sales at Randy's continue to be as strong as ever.

(Continued from page 2)

We also asked donut shops across the country to share their views of what is happening with consumer buying habits and what factors they believe are playing most heavily into the equation.

One of the many advantages for the donut business is that consumers continue to perceive donuts as “comfort foods,” a fresh product that they know and love. Donuts also are well positioned for America’s increasingly mobile society, as a hand-held food that is easily consumed on the go.

Retail donut shops and full-line bakeries that depend on donuts for everyday traffic need help to ride out the economic storm. Dealing with the economy is never easy, but we hope you find strategies and tactics presented in this issue to benefit your retail donut business.

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