

IMPROVEMENT OF PRICE FORMATION MECHANISM IN PUBLIC EATING ESTABLISHMENTS

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Abstract

The author proposes a new mechanism of price formation in public eating establishments, which represents a combination of goods and services: a) food preparation, b) sale of goods, c) organization of consumption. Since public eating establishments represent an activity which combines the production with services, the author suggests keeping separate accounting of production and circulation costs. This is only the initial phase of price formation mechanism in public eating establishments.

The next phase is to establish the resulted price, which includes the associated discounts depending on consumers' demand for cooked dishes and marketing actions to serve customers.

The author concludes that the price formation mechanism cannot be based on the calculation of cost of goods plus the bonus of trader, but this process should be adjusted through the marketing approach based on consideration of factors (behavioral, visual, indirect etc.) which influence the customers' behavior.

Keywords: *public eating establishments, mechanism, price, premium of trader, weighted average price, marketing approach.*

JEL classification: D24, E64

1. Introduction

The specific of price formation in public eating establishments is related to the specifics of business activity in the respective field. The transition of catering business to market economy increases the responsibility of companies in the field of price formation for raw materials, purchased goods as well as their own production.

The prices in public eating establishments belong to the system of retail prices, but the methods of their calculation differ from the methods used in retail trade. This specific is due to the fact that public eating establishments are producing and selling their own produced goods as well as purchased goods (bread, confectionery, tobacco goods, etc.).

At present the majority of public eating establishments are making their own rules for price calculation through assessment of market demand and supply. The mechanism of price formation is very complicated and is regulated by the Instruction regarding formation of prices in public eating establishments of all types of economic agents of Republic of Moldova no.12 adopted in 1996, the Government Decision no. 547 of 04.08.1995 "About the measures of coordination and regulation of prices (tariffs) by the state" and other legal texts.

2. Specifics of price formation in public eating establishments

Generally the price formation is based on the production cost of each product or service. Despite that, in public eating establishments the production cost per unit cannot be calculated because they do not keep records of expenses per unit of goods. For this reason they determine directly the selling price of good, which is interpreted as the retail price. But this price is different from the trader's retail price because they use an extra premium in price of goods. This extra premium depends on the type of facility and its specialty, methods of service and purchasing capacity of customers. Besides that they use different prices for goods purchased from other sources. Thus, the price of raw materials is shown in the records as the retail price, which is calculated as a sum of purchasing price, trader premium and VAT.

Some types of raw material and goods used in preparation of a course are bought in industrial packaging at retail prices per each bottle and pot, including the packaging (gross). Because in the calculation of a course price the raw material is included in kilograms it is necessary to determine the price per kilogram of raw material taking into account the net weight of the bottle or pot.

The premium amount is regulated by the Government Decision no. 547 of 04.08.1995 "About the measures of coordination and regulation of prices (tariffs) by the state" and further amendments to it. According to Article 3 of this Decision the amount of premium should not exceed 30% for the 3rd category public eating establishments, for the 2nd category establishments – 70% from the retail price or raw material cost. The amount of premium is unlimited per each type of culinary preparation (with the exception of the 2nd and 3rd category establishments) if it is approved by decision of management and are not social goods.

3. Stages and methods of price calculation in public eating establishments

The process of price calculation can be represented as follows:

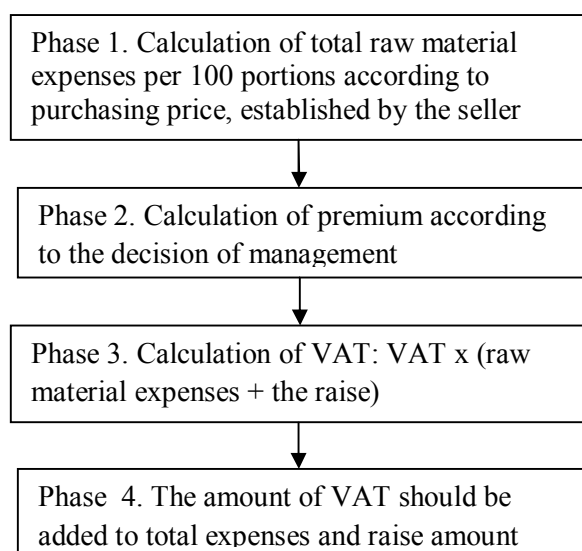


Figure 1: Calculation of selling price of goods at public eating establishments

Source: Developed by the author.

The calculation of selling price per each good is made using technical cards, which contain the following information: consumption of raw material, quantity of issued goods, average price. The

average price is determined as a ratio of total amount of raw material (in retail prices) to quantity, taking into account the waste allowance (see Table 1).

Table 1: Calculation of average price per 1 kilo of cabbage

Retail price, kg	Received quantity of goods, kg	Total value	Waste allowance	Quantity of goods evidencing the waste allowance
10.87	31.92		0.8465	
11.90	18.37		0.8465	

Source: [8].

This method of calculation allows to avoid errors in calculation of goods price in public eating establishments and to accumulate a huge amount of information regarding direct costs per unit of raw material used in this estimation. The information shown in technical cards will be used in the accounting for calculation of selling price of a course and confectionary (see Table 2).

Table 2: Technological card for preparation of dishes

Name of course: **Pyramid of eggplant with cheese**

Raw material	Incoming and outgoing norms			
	I		II	
	Gross	Net	Gross	Net
Eggplant	945	898/700*		
Cheese	204	200	205	210
Total: Amount of resulted dish		800		800

* Amount of roasted eggplant

Source: [8].

The technological card for preparation of dishes is issued for original dishes, because these recipes are not contained in the Recipe book of 1981 and they should be approved by the management.

An essential part of retail price represents VAT, which amounts to 20%, notwithstanding with VAT of purchased raw material and goods – 8 or 20%. Thus, the selling price in the calculation card would be determined as raw material cost plus premium of public eating establishment plus VAT amount.

Taking into account the huge number of goods, it is too complicated to perform such calculations on every day basis at public eating establishments. Therefore it's reasonable to calculate the normative cost of preparation of goods for a month. Using the method of normative cost would allow to plan and set a norm for preparation of goods, to prepare internal reports and set a control based on normative costs.

On the other hand, some types of raw material, shown in the Recipe book of 1981, are not always available. In this case it's possible to substitute the item with another raw material using the substitution ratio contained in the Recipe book.

If the company decides to produce a new dish, for which the norms of waste and losses during preparation is not available in the Recipe book, then companies may perform the control testing by themselves and the results should be fixed in a paper.

The specific of price formation in public eating places consists in the fact that the price for the same item will change because of fluctuation of raw material and purchased goods price, and thus the selling price needs to be recalculated.

In public eating establishments the production cost is determined without raw material cost. It is explained by the fact that raw material and purchased items by their economic meaning represents goods, which can be sold to final customers like in the retail trade. For this reason the production cost in public eating places represents not the full cost of production, but only costs occurred with their own production (transportation and warehousing of raw material and semi-finished products, wages of employees in production area, heating and electricity cost for production purpose, depreciation of fixed assets in the production area etc.).

At present the public eating market has started a new era of development. The public eating market not only fulfills consumers' demand for cooked goods and services, but also represents a chain to cover the demand for social important goods. The Addendum no. 3 to Government decision no. 547 of 04.08.1995 "About the measures of coordination and regulation of prices (tariffs) by the state" contains the list of social important goods (services).

At the same time the Government decision no. 547 does not limit the prices for dishes, but only the retail prices of goods. It does not encourage the public eating establishments of 2nd and 3rd categories to include in their range of goods dishes at lower prices for population with low income. The State should designate a chain of social eating establishments without category to serve population with low income by offering them a reduction in income tax or VAT.

In our opinion it is reasonable to approve a Government decision "Regarding approval of mechanism of price formation for goods and services of social importance" by adding Article 4 concerning the formation of prices in public eating establishments as follows: "For social eating places without category the prices for dishes will be limited to a narrow range of dishes according to the attached list of socially important goods/services".

According to the National Accounting Standards the cost of goods distributed in public eating places is constituted only from the cost of goods which were used to prepare these dishes because public eating establishments are considered a trade activity. On the other hand, this method of cost calculation in public eating establishments is criticized by some specialists, who believes that public eating establishments represent a process of dishes preparation the same as in the food processing industry and suggest to increase the basis for calculation of VAT by adding all costs for preparation of dishes: cook wages, tear-and-wear of fixed assets, electricity and heating etc. despite the provisions of National Accounting Standards.

In our opinion, both ways of VAT calculation do not take entirely into account the specifics of public eating establishments, which represent a combination of goods and services referring to: 1) preparation of dishes, 2) commercialization of goods, and 3) organization of consumption. To express the real content of the activity of public eating establishment we suggest using the following formula:

$$P_g = P_m + S \quad (1)$$

where

P_g - the product as a result of the whole company activity relative to customer's needs;

P_m - the material product, which includes preparation of dishes, confectionary in public eating establishments;

S - services provided (basic services to satisfy the gastronomic needs, services to get a profit, services to organize the consumption depending on the efforts of employees, additional services to increase the attractivity of basic services, services which stimulate the increase of value perceived by the customer, nonmaterial services noticed by customers through different benefits offered).

Thus the service represents an activity which increases the utility of a product for the customer. The quality and quantity of services provided are assessed in accordance with the National Standards. All these elements should be taken into account while fixing the amount of trader's premium by the public eating establishment. The trader's premium should cover all direct and indirect costs related to preparation and serving meals.

It's reasonable to take into consideration a set of indirect price factors, such as psychological or subjective factors. For evidencing indirect factors the administration of public eating establishment should contact more often with customers and know its competitors. If the company decides to fix higher prices compared to average prices its decision should be justified with an exclusive customer service.

The most important indirect factors which justify higher prices are: a refined atmosphere, interior of building, category of customers and their financial possibilities, competitors' prices for prepared dishes, additional conveniences when serving customers (a convenient car parking etc.), presentation of special offers in the menu, special service of customers in restaurants and bars (offering free newspapers, magazines, illustrations, paper for notes with a pen next to a telephone set, a menu with specialties of the house signed by the owner etc.). Customers would note these marketing actions and would not criticize the newly established prices. Presenting a dish in an unusual way would change their perception by the customers and often determines the customer to make the choice in favor of the waiter and other personnel in public eating establishments.

The formation of prices in public eating establishments is influenced by psychological factors. For instance, using unrounded prices, ending in 5 and 9 is understood as lower prices compare to prices rounded to 0 (zero). Thus the price of 8.95 is more attractive than 9 psychologically, because the rounding will be made to 8, not to 9. Unrounded prices allow customers to revise their budget and to divide their purchases in several categories: compulsory purchases (food, transportation costs, electricity and heating, etc.), purchases with social purpose (visiting restaurants for jubilees and other events).

The price formation process should take into account some subjective factors also and cannot be based on calculation of dish cost and trader premium only. The modern approach to price formation assumes that calculation of production and circulation costs is only the beginning of the process, which should be adjusted with a set of factors (indirect, psychological and subjective factors). If we compare the prices of the same dish prepared with the same ingredients at public eating establishments of same category in different cities and regions of the Republic of Moldova we will notice that menu prices are very different. This is because the menu prices depend on the standard of life in different cities.

4. Conclusions

Since public eating establishments represent a combined activity of goods and trade (service) we suggest to keep separate records of production and circulation costs. The production costs should include only costs related to the preparation of meals and the cost of confectionary should be calculated based on real costs. The selling price should be determined by adding to the real cost of confectionary the amount of premium, which varies depending on demand and offer situation. The

experts recommend that circulation costs include only expenses related to the organization of consumption in public eating establishments [7, pp. 216-217].

Such an approach would allow determining the price of services in public eating establishments correctly, which is very important for decision making process in the choice of mechanism of price formation for dishes, confectionary and purchased goods.

It is necessary to establish the method of distribution of indirect production costs in the cost of meals prepared during a certain period (decade or month): cooks and waiters' salary, amortization of fixed assets, rent, electricity and heating. The evidence of such costs should be carried automatically using the software which divides the indirect production costs.

Dividing indirect production costs proportionally to the cost of raw material used in the preparation of courses is difficult because there is no direct connection between the costs carried with preparation of meals (cooks salary, electricity and heating, etc.) and the cost of goods used in production. For this purpose it is necessary to revise the method of meals cost calculation through additional research, which is available in specialized literature.

At the same time the separate evidence of production and circulation costs is only the beginning of price formation mechanism in public eating establishments.

It is possible to solve this problem using the Western model of accounting, according to which the selling price depends on the demand level [7, pp. 215-216]. In such case we don't use technological cards for calculation of selling price for each type of dish.

In our opinion it is worth to establish a combined method of price formation based on calculation of basic catalogue price plus the resulted price, which includes associated discounts depending on the demand level for a certain dish. The most important elements which should be taken into consideration while establishing the final price are: identification of potential customers, estimation of demand, anticipation of competitors' reaction, fixing the share of market, selection of price strategy corresponding to this market segment, including a profit in the price, correlation of price strategy with other marketing policies [4, p.382].

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