The Restaurant Wizard

Practical Guide to Restaurant Reporting

www.therestaurantwizard.com

The restaurant industry is one of the most difficult industries in which to succeed because prime costs for food and labor can amount to as much as 65% of sales for full-service restaurants, necessitating tight controls to maximize day-to-day profits.

Effective Financial Reports Have a Dual Purpose

1) Determine the absolute profitability of the restaurant (Profit Purpose).
2) Report variances of actual results from a budget or goal. Such information can be used to improve the operational results and profits (Control Purpose).

Profit Purpose

Financial information can be organized in multiple ways. Because tens of millions of people around the world work with financial information for various purposes, accounting standards have been developed for consistency across companies and industries. The five basic groupings of accounts are income, expense, assets, liabilities and equity.

The focus here is restaurant-specific income and expense.

The National Restaurant Association has developed a chart of accounts specifically for restaurants. This effort comes from a shared understanding of what is important to restaurant owners and managers, as well as a desire to have some way of cross-checking how one restaurant is performing against another. Suggested Charts of Accounts for Fast Food and with and without Bar Service, compatible with the NRA statistics, are available on the website.

Deloitte publishes an annual survey of restaurant performance. All expense information is converted to a percentage of sales. The food cost for independent restaurants with average checks below $15 was 35% in 2010, with a range of 30.8% to 42%. Deloitte's survey also shows expenses compared to the number of seats and the number of employees.

With all of the creativity and different approaches so common in restaurants, there is no absolute way to know if you are as profitable as you could be. For example, on the income side, you make decisions about the highest price you can reasonably charge for your food based on what is comfortable for your customers, food quality, service and décor. What you can charge for your food also depends very much upon competitors' prices in your immediate area.

On the expense side, you make decisions on ingredient quality versus the price at which you can sell the food. You make staffing decisions on your service style based upon what you can afford with your prices and what makes you stand out from your competitors.

While you cannot ever know if you are making as much as you could, you can know if you are as profitable as your direct competitors are. Based on an annual restaurant industry survey, by reporting income and expenses in a way that is consistent with the industry, you can at least determine how your costs stand against similar restaurants doing similar things. For example, if your occupancy costs are several percentage points higher than average of those at a comparable level of revenue, you must be sure that the higher cost is necessary to sustain your sales volume. The cause might be that you may be paying more for an A site than a C site, or maybe you have put more money into décor. Whatever the reason, the strategy is not working as planned because you are at a competitive disadvantage against someone with a lower occupancy cost percentage and similar sales.

One of the most important measures across all industries is gross profit. This is the profit after paying for the raw material cost of your product. For the restaurant industry, gross profit is profit after subtracting food cost.

The Restaurant Wizard supports Jim Laube and others who are focusing attention on “prime profit,” which is the profit after both food and labor costs. As stated above, these two costs can amount to as much as 65% of sales for full service restaurants, and they are controllable expenses based on both on the decisions you make about your restaurant and how well you manage to the theoretical costs. You need to focus on profit after both costs, because you make many trade-offs trying to find the right balance for the customer. Will total sales be higher with higher food quality/cost and more casual service, by combining lower food quality/cost with fuller service, or some other combination?

If the net result of all of your decisions on pricing, menu selection and service standards leaves you with prime costs 5 or 10 percentage points higher than similar restaurants, you are at a very big competitive disadvantage and something must be done. The Practical Guide to Restaurant Food Cost Control and Practical Guide to Restaurant Labor Cost Control documents on the website go into more depth on cost controls.

Control Purpose

The second use of financial statements is to provide information to help increase sales and control costs. The important idea is the ***variance***. You need to know what is happening to be able to affect it. The variance is how much a specific revenue or cost item differs either from last year or from a budget or goal. Most financial statements show variances in dollars. For instance, sales are up $2,000, or 7% above either the budget or last year’s figures. If food cost is also up $900 or 9%, you have a problem, because the cost is up more than the revenue.

But you don’t need to keep the 7% sales variance in your head to know how well you’re doing. Another way to understand financial information is variances as a percentage of sales. In the example above, you would see that your food cost changed from 35% to 35.7%, which can be stated as “the food cost was .7 percentage points worse.” But if your rent is a fixed $2,000 in the above example, your rent percentage would have gotten .5 percentage points better, with a decline from 7% to 6.5%. Using variances of sales you can quickly see how you are doing across your whole financial statement.

Looking for variances against last year is important for understanding whether the collective effect of all of your business decisions is causing an improvement. Even if your expense for an item is exactly the same from one year to the next, as with the rent in the previous example, your variance in percentage of sales will get better if your sales go up. So by looking at the percentage variance, you can easily see what things are getting better or worse.

Looking for variances from a goal is important in helping you actually affect the results. If a variance shows that you are going off course as a percentage of sales, a correction needs to be made to prevent a problem from causing significant year-to-year profit variances. Often that means retraining staff on one or more control processes.

For some of your expenses, it is not enough to divide total expense by total sales. As an example, server labor must be looked at as a percentage specifically of dining room and banquet food sales. If carryout or delivery becomes 10% of your food sales, your server labor cost percentage will seem to improve, but you lose track of what is really happening. The percentage has to be built correctly. You might look at ToGo Packaging Expenses as a percentage of carryout and delivery sales.

Food Cost Reporting

If you are willing to take weekly inventories, it is possible to produce an accurate weekly food cost. Whether it is worth the effort depends upon how well established your controls are. If your controls are in place, there will not be much variation from week-to-week, so knowing the results monthly is enough to confirm that you remain on track. If you are falling off of the goal, you may temporarily put weekly inventories in place to more rapidly determine your success at reestablishing controls. The Practical Guide to Restaurant Food Cost Control document on the website goes into more depth on food cost controls.

Labor Cost Reporting

Weekly labor cost is easy to determine but of limited use. To be effective, labor must be managed at the daily breakfast, lunch or dinner shift level. You may have a very small variance from labor percentage goal for the entire week, but that can hide problems. You may be significantly favorable some shifts and unfavorable on others and only have a small weekly net variance.

The labor percentage is very sensitive to sales. Even if you have a significant percentage variance from goal for a shift, the reason is usually a corresponding variance in sales rather than the result of a labor-scheduling problem. The percentage variance may not be a control issue.

Most labor cost is a fixed cost for a shift. You staff to meet your expectation about how many customers you are going to have for the shift. If you get unexpectedly busy for a shift, your labor percentage variance will be automatically favorable. If you have the expected number of customers but an employee did not show up for a shift, your labor percentage variance will be favorable. If you are unexpectedly slow, with the exception of some small control opportunities from sending servers home earlier, you will have an unfavorable labor percentage variance. The Practical Guide to Restaurant Labor Cost Control document on the website goes into more depth on labor controls.

For more information, tips and tools, visit www.therestaurantwizard.com.