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## How to Manage Your Restaurants Critical Numbers and Avoid Financial Loose Ends

by Chirs Tripoli and Jim Laube

**When looking to open your restaurant, most people will emphasize the importance of three things: location, location, location. Once you have opened, everyone will tell you that the three things you need to master to succeed are numbers, numbers, numbers.**

It is hard enough to operate well in today's competitive restaurant market considering the time commitment, quality control, customer service standards and labor management. It becomes much more difficult to succeed if you cannot "tie" your numbers together in a way that helps you plan effectively, manage costs more efficiently and increase profits.



And what numbers are we talking about when there are so many to track? There are annual plans, sales forecasts, operating budgets, daily sales records, inventories, cost of sales, controllable expenses, occupancy costs, shareholder value, sales-to-investment ratios and more.

So what numbers do we need to track regularly and consistently? Why are they so important? What do they tell us? When do we need to know them? And how do we use them to increase sales and maximize profits?

If you were Ron Shaich, CEO of Panera Bread, you might answer with:

1. Same-store sales comparison.
2. Number of new restaurants scheduled to open.
3. Stock value.

In a recent interview Shaich said that Panera's numbers tell the tale. The company's same-store sales results for restaurants open at least a year were up 3.4 percent last year and up slightly this year. Its stock value was up 50 percent last year, ranking among 2008's most successful restaurant stocks, and it is the best-performing major restaurant stock in the past decade, with an annualized growth rate of 31.5 percent. Sales in 2008 topped 2.6 billion and shares are off less than 1 percent in 2009 (source: *USA Today*).

But since you are most likely not the CEO of a public restaurant company with more than 1,260 stores in 40 states and 80 more opening this year, you are not likely to use this information to better manage your restaurant operation. The "triple play" of numbers for most independent restaurant operators is simply *sales, expenses and profit*.

We have found that too many owner/operators are not tracking sales accurately, not posting costs by category correctly, and/or viewing a cash balance at the end of the month as profit. These errors and misconceptions prevent us from managing our operations profitably. Unless you know how to interpret your financial data and identify relationships between various financial reports, you really don't know how your business is performing. Let's start by taking a look at a good sample monthly reporting method and determine what items belong to what category.

### First, Tie in the Monthly Report

The "Profit and Loss Summary" on the right provides an outline of the kinds of information you want to be able to track at a glance monthly. Please refer to it as you read the following:

**Sales.** Begin by recording sales by category. Food typically includes nonalcoholic beverages (tea, coffee, juices and soft drinks). Separate the alcoholic beverage revenue by liquor, beer and wine. Some restaurant operations that sell a large amount of beer prefer to separate that category into draft and bottle sales. In some cases where retail items are offered for sale (e.g., T-shirts, gifts, sauces) it is recommended to add a retail or miscellaneous sales category.

**Cost of sales.** This is a category where accuracy is definitely required and yet many operators make the same common mistake. It is important that the cost of sales be calculated as a percent of their corresponding sales category and not by total sales. Food cost should be divided by food sales, beverage cost by beverage sales, and retail cost by retail sales. The diagram "Properly Calculating Cost of Sales," below, provides an example of the percentage cost difference you receive when calculating these items correctly and incorrectly. As illustrated in the lefthand column, using the total sales as the denominator results in a deceptively low cost of sales for both food and beverage. In the righthand column, the cost of sales is derived by dividing the cost of each category by the respective sales of each category.

MONTHLY PROFIT & LOSS SUMMARY	
<b>SALES</b>	
Food	
Liquor	
Beer	
Wine	
	TOTAL SALES
<b>COST OF SALES</b>	
Food	
Liquor	
Beer	
Wine	
	TOTAL COST OF SALES
<b>GROSS PROFIT</b>	
<b>PAYROLL</b>	
Salaries & Wages	
Employee Benefits	
	TOTAL PAYROLL
<b>PRIME COST</b>	
<b>CONTROLLABLE EXPENSES</b>	
Direct Operating Expenses	
Music & Entertainment	
Marketing	
Utilities	
General and Administrative Expenses	
Repairs & Maintenance	
	TOTAL OCCUPANCY COSTS
<b>CONTROLLABLE PROFIT</b>	
<b>OCCUPANCY COSTS</b>	
Rent	
CAM	
Property Taxes	
Other Taxes	
Property Insurance	
	TOTAL OCCUPANCY COSTS
<b>INCOME BEFORE INT. &amp; DEP.</b>	
Interest	
Depreciation	
<b>INCOME BEFORE TAXES</b>	

### PROPERLY CALCULATING COST OF SALES

SALES		INCORRECT		CORRECT	
Food	\$ 78,500	79%	\$ 78,500	79%	
Beverage	21,500	22%	21,500	22%	
TOTAL SALES	100,000	100%	100,000	100%	
<b>COST OF SALES</b>		<b>INCORRECT</b>		<b>CORRECT</b>	
Food	<del>25,200</del>	<del>25%</del>	25,200	32%	
Beverage	<del>6,500</del>	<del>7%</del>	6,500	30%	
TOTAL COST OF SALES	<del>31,700</del>	<del>32%</del>	31,700	32%	

As illustrated in the left hand column, using the total sales as the denominator results in a deceptively low cost of sales for both food and beverage. In the right hand column, the cost of sales is derived by dividing the cost of each category by the respective sales of each category.

**Payroll.** In most cases this category represents the single largest cost item. It is important to track payroll cost by separate departments - store personnel (hourly employees) and management (salary personnel). Payroll taxes and employee benefits are to be included in this category of your restaurant P&L.

**Controllable expenses.** These categories include each of the items required to operate your restaurant that are controlled by decisions made by ownership, management or staff. Categories within this section are direct operating expenses, music and entertainment, marketing, utilities, general and administrative expenses, and repair and maintenance costs.

**Direct operating expenses.** This includes uniforms, laundry-linen, tableware-glassware, kitchen utensils, cleaning supplies, paper, bar supplies, menus-printing, contract cleaning services, decorations-flowers, and miscellaneous.

**Music and entertainment.** Includes payment to professional musicians if appropriate to your concept, as well as annual fees-permits to ASCAP, BMI or other music licensing agencies. Marketing is the correct category for any/all advertising-related expenses such as print ads, coupons, promotions and research.

**Utilities.** Includes the charges for electricity, gas, water and trash removal.

**General and administrative.** These expenses include the fees and service charges required (and often overlooked) when budgeting for your restaurant. Examples include bank charges, cash over-short, credit card charges, postage, printing-office supplies, professional fees (accounting-legal-consulting), security services, license permits, telephone and fax.

**Repair and maintenance.** This category includes costs associated with building repairs, equipment repairs and maintenance contracts.

**Occupancy costs.** This section is for the cost of rent (base and percentage) common area maintenance fee (CAM) property taxes, insurances and other taxes.

Logic would tell you that you can't begin to make sense of your numbers if you do not have

accurate reporting of the numbers. You need to get your accounting house in order from the very beginning; otherwise you are flying blindly from one month to the next. That said, if the first step to tying numbers for a better restaurant operation is proper monthly reporting of sales and costs, the second step is accurate management practices.

## Second, Tie in the Monthly Inventory

Taking a physical inventory at the end of each reporting period is a basic practice and one that is mandatory to the maintenance of accurate cost numbers. Relying on par levels or inventory averages will distort the cost of food and beverage items. An accurate physical inventory is needed to correctly determine your cost of sales. Accurate cost-of-sales figures are a prerequisite to controlling food and beverage costs.

In the example illustrated in "The Importance of a Proper Physical Inventory" below. The restaurant without an inventory is figuring its cost of sales on purchases rather than usage. This is inaccurate and creates a cost number that doesn't tie into the operation and cannot be correctly compared with the industry standard.

### THE IMPORTANCE OF A PROPER PHYSICAL INVENTORY

	Without Physical Inventory		With Physical Inventory	
<b>COST OF SALES CALCULATION</b>				
Purchases	\$10,000		\$10,000	
Add: Beginning Inventory	-		3,000	
Deduct: Ending Inventory	-		(6,000)	
Cost of Sales	<u>10,000</u>		<u>7,000</u>	
<b>PROFIT &amp; LOSS STATEMENT</b>				
Sales	\$25,000	100.0%	\$25,000	100.0%
Cost of Sales	<u>10,000</u>	<u>40.0%</u>	<u>7,000</u>	<u>28.0%</u>
Gross Profit	<u>15,000</u>	<u>60.0%</u>	<u>18,000</u>	<u>72.0%</u>

**The restaurant without an inventory is figuring its cost of sales on purchases rather than usage. This is inaccurate and creates a cost number that doesn't tie into the operation and cannot be correctly compared to the industry standard.**

Fluctuations in inventory levels do not affect food cost, provided an accurate beginning and ending inventory is taken. An inaccurate ending inventory means a dollar-for-dollar misstatement of your true food cost.

There is a 37-year-old family-operated seafood restaurant in Columbus, Ohio, that just started preparing complete inventories at the end of each month. The operators had maintained a relatively constant inventory level and divided sales into purchases to figure cost of sales. This was inaccurate and created an incorrect monthly profit. After reviewing current food cost figures they are better able to tie the numbers together and take steps based on accurate information. They have since updated their menu item cost and for the first time are able to compare them with the item sales reports to complete an ideal food cost projection. Tying numbers

“...In a low-margin business in which sales can fluctuate and controlling costs requires constant vigilance, operators of consistently profitable restaurants don't wait until

together accurately shows us the true picture of things so we can make decisions and plan accordingly.

the end of the month to learn how their restaurant performed.. ”

In regard to comparing your numbers with industry standards, for many years we have recommended the use of the [National Restaurant Association's](#) (NRA) "Uniform System of Accounts for Restaurants." This book shows you how to put in place an accounting system designed for the foodservice industry. It provided a comprehensive listing of accounts for assets, liabilities, revenues and expenses along with a complete description of the types of transactions that should be classified in each account.

Using the uniform system of accounts allows the preparation of financial statements into industry-standardized formats, which makes it possible to compare your operation's operating statements with industry averages.

In addition, the NRA annually publishes foodservice industry operating averages from data provided by NRA members in the "Restaurant Industry Operations Report." Many state associations also publish similar reports from participating operators in their respective states.

The Uniform System of Accounts for Restaurants is out of print; however, if you can find the most recent edition, published in 1996, it is still useful. (We understand that the NRA is considering printing an updated edition in the future. We will keep you posted as this develops.) The Restaurant Industry Operations Report may be purchased by calling the National Restaurant Association at (800) 424-5156, ext. 5375. Restaurant operators who use the "Uniform System of Accounts" get a better understanding of what their operating numbers are telling them.

### Three, Tie in the Audit Trail

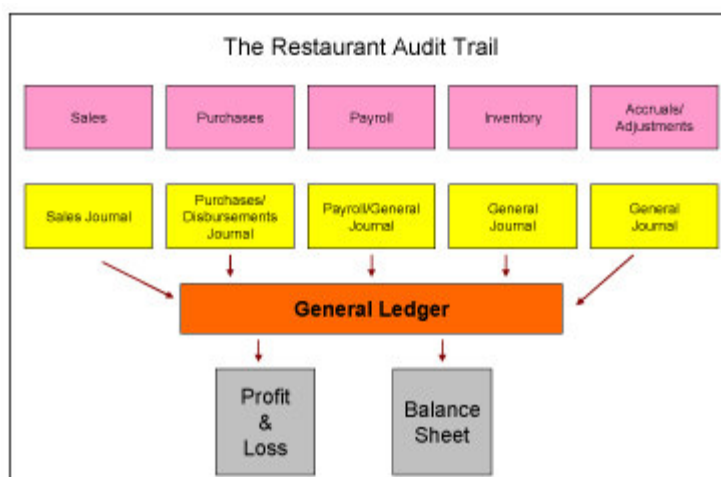
For owners and managers to use operating numbers for our benefit, we must first be able to locate the numbers, and then understand what they represent.

Each shift a manager reads the register and posts the sales amount. At the end of the day a daily sales report is usually completed with total sales, paid-out expenses, tips paid and other items. These entries form a sales journal. Just as with sales, each day purchases are made, deliveries received and amounts posted on a journal by cost category (e.g., meat, seafood, grocery). These entries form the purchase-disbursement journal. Each time payrolls are completed (weekly, twice monthly) the payroll journal listing each detail by person and by department is created. At the end of the reporting period a complete inventory of all food and beverage items is entered into the general ledger by category. This inventory amount becomes the beginning inventory amount for the next period. Knowing where the numbers come from makes it so much easier to manage by the numbers, and to find the right numbers when you need to review a particular cost.

“ ...The reason Prime Cost is such an important number is that it provides feedback on how well a restaurant manages its largest and most volatile costs: food, beverage and hourly labor.. ”

Managers and their key staff should review their restaurant's monthly profit-and-loss statement as soon as it is available. The P&L is the unit's monthly report card. For many who track sales, labor cost and purchases each week, the P&L may be more confirmation rather than information. In any case there are typically a few items that appear questionable and deserve further review and attention.

Where do we go when we have cost questions? You ask the restaurant audit trail, as illustrated below.



For example, if the profit-and-loss statement indicates a meat cost of 11.3 percent and your restaurant normally runs an 8 percent you would check the general ledger to see that the beginning inventory and ending inventory were correct. You would review the purchase journal to confirm that purchase transactions were recorded properly. In this case there was a meat purchase posted twice. This artificially increased the meat purchase total, which led directly to high cost percentage on the P&L.

In another example, all food and beverage costs looked higher than previous months. A check of the sales journal showed that neither of the catered private parties had been recorded. When the sales were adjusted, the cost percentages for each food and beverage category appeared to be in line with budget.

### **Tied and True**

Michael Passalacqua, owner of Angelo's in Washington, Pennsylvania, ties together selected numbers each week for his managers' meeting. He learned that by taking inventory of key items and totaling food and beverage purchases each week, managers could estimate a food cost at each meeting. This kept them better educated and more aware of lost-of-sales trends. By tying weekly staff schedules to recent payroll journals, Michael is also able to estimate hourly labor cost each week.

In Austin, Texas, Mark Fleming, manager of Chez Zee American Bistro, prepares weekly numbers each Monday for their restaurant managers' meeting. Mark breaks out sales records by day, compares them with plan, and the most recent six-week average. By listing per-person check averages and daily customer counts, managers can better tie sales trends together. Goals are set and specials developed to maintain check averages and sales levels. This has proven to be a successful tool in keeping the management team focused and sales levels maintained.

### **Tying it All Together**

Whether it's for sales forecasting or cost confirming, knowing where your numbers come from and how to find them when questions are asked is a necessary first step to properly tie your numbers together and manage your restaurant more effectively.

-- [Restaurant Startup & Growth](#)

## Case in Point: The Value of a Proper Inventory

A popular catfish restaurant noticed a spike in the cost of seafood on their recent profit-and-loss statement. This was particularly disturbing considering that the price of most seafood had been lower than previous months. A disturbed management team reviewed the purchase journal carefully, confirming each transaction. They became more confused when each delivery, quantity and price checked out. A closer look at the ending inventory showed the dollar amount to be much lower than usual. Further review of the inventory showed one storage refrigerator was not included in the count. Once the inventory was adjusted, the seafood cost appeared to be in range.

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## Tying in Your Prime Cost

Almost without exception, the most successful independent operators we see today not only deliver a quality dining experience for their customers, but also keep a constant watch on the financial performance of their restaurant. As one of our readers recently said, "If you don't know your numbers, you don't know your business."

In a low-margin business in which sales can fluctuate and controlling costs requires constant vigilance, operators of consistently profitable restaurants don't wait until the end of the month to learn how their restaurant performed. While their monthly or four-week financial statements are important, they're used mainly to confirm what they already know. As another operator said, "If I waited until the end of the month to know how my restaurant was doing, it would be too late."

To get meaningful, timely information on how their restaurant is doing, many get a "Prime Cost" report at the end of each week.

A "Prime Cost Report" includes cost of sales (food, beverage and paper goods in quick-serve restaurants) and all payroll costs, including the gross wages of management and hourly staff plus payroll taxes and employee benefits such as workers' compensation and employee insurance. (RestaurantOwner.com members can access a Weekly Prime Cost Worksheet at [www.restaurantowner.com/public/189.cfm](http://www.restaurantowner.com/public/189.cfm).)

The goal in most table-service restaurants is to keep Prime Cost, as a percentage of total sales, at 65 percent or less. Quick-serve restaurants often shoot for a Prime Cost at or below 60 percent of sales. The reason Prime Cost is such an important number is that it provides feedback on how well a restaurant manages its largest and most volatile costs: food, beverage and hourly labor. These three costs often represent 90 percent of the costs in most restaurants that are controllable in the short term.

Calculating prime cost weekly, 52 times a year, versus monthly gives operators a good shot at nipping any problems in these areas quickly.

Many smart operators also know their sales break-even point based on monthly and weekly sales volumes. Knowing their sales break-even and understanding the relationship between sales volume and their restaurant's operating costs, they can quite accurately peg how much profit their restaurant should make per week or month based solely on the amount of sales generated.

These operators develop profit expectations based on knowing just their sales volume. If the actual numbers on their profit-and-loss statement (P&L) differ from this by much it usually means

either their P&L contains errors or they have an operational problem to deal with.

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