Chapter 1

MANAGING REVENUE AND EXPENSE

OVERVIEW

This chapter presents the relationship among foodservice revenue, expense, and profit. As a professional foodservice manager, you must understand the relationship that exists between controlling these three areas and the resulting success of your operation. In addition, the chapter presents the mathematical foundation you must know to express your operating results as a percentage of your revenue or budget, a method that is the standard within the hospitality industry.

Chapter Outline

HIGHLIGHTS

At the conclusion of this chapter, you will be able to:

- Apply the basic formula used to determine profit.
- Express both expenses and profit as a percentage of revenue.
- Compare actual operating results with budgeted operating results.

PROFESSIONAL FOODSERVICE MANAGER

There is no doubt that to be a successful foodservice manager you must be a talented individual. Consider, for a moment, your role in the operation of an ongoing profitable facility. As a foodservice manager, you are both a manufacturer and a retailer. A professional foodservice manager is unique because all of the functions of product sales, from item conceptualization to product delivery, are in the hands of the same individual. As a manager, you are in charge of securing raw materials, producing a product, and selling it—all under the same roof. Few other managers are required to have the breadth of skills that effective foodservice operators must have. Because foodservice operators are in the service sector of business, many aspects of management are more difficult for them than for their manufacturing or retailing management counterparts.

A foodservice manager is one of the few types of managers who actually have contact with the ultimate customer. This is not true of the manager of a tire factory or automobile production line. These individuals produce a product, but they do not sell it to the person who will actually use their product. In a like manner, grocery store or computer store managers will sell their product lines, but they have had no role in actually producing their goods. The face-to-face guest contact in the hospitality industry requires that you assume the responsibility of standing behind your own work and that of your staff, in a one-on-one situation with the ultimate consumer, or end user of your products and services.

The management task checklist in Figure 1.1 shows just some of the areas in which foodservice, manufacturing, and retailing managers vary in responsibilities.

In addition to your role as a food factory supervisor, you must also serve as a cost control manager, because, without performing this vital role, your business might cease to exist. Foodservice management provides the opportunity for creativity in a variety of settings. The control of revenue and expense is just one more area in which the effective foodservice operator can excel. In most areas of foodservice, excellence in operation is measured in terms of producing and delivering

■ **FIGURE 1.1** Management Task Checklist

Task	Foodservice Manager	Manufacturing Manager	Retail Manager
1. Secure raw materials	Yes	Yes	No
2. Manufacture product	Yes	Yes	No
3. Distribute to end-user	Yes	No	Yes
4. Market to end-user	Yes	No	Yes
5. Reconcile problems with end-user	Yes	No	Yes

quality products in a way that assures an appropriate operating profit for the owners of the business.

PROFIT: THE REWARD FOR SERVICE

There is an inherent problem in the study of cost control or, more accurately, cost management. The simple fact is that management's primary responsibility is to deliver a quality product or service to the guest, at a price mutually agreeable to both parties. In addition, the quality must be such that the consumer, or end user of the product or service, feels that excellent value was received for the money spent on the transaction. When this level of service is achieved, the business will prosper. If management focuses on controlling costs more than servicing guests, problems will certainly surface.

It is important to remember that guests cause businesses to incur costs. You do not want to get yourself in the mind-set of reducing costs to the point where it is thought that "low" costs are good and "high" costs are bad. A restaurant with $5 million in revenue per year will undoubtedly have higher costs than the same size restaurant with $200,000 in revenue per year. The reason is quite clear. The food products, labor, and equipment needed to sell $5 million worth of food is likely to be greater than that required to produce a smaller amount of revenue. Remember, if there are fewer guests, there are likely to be fewer costs, but fewer profits as well! Because that is true, when management attempts to reduce costs, with no regard for the impact on the balance between managing costs and guest satisfaction, the business will surely suffer. In addition, efforts to reduce costs that result in unsafe conditions for guests or employees are never wise. While some short-term savings may result, the expense of a lawsuit resulting from a guest or employee injury can be very high. Managers who, for example, neglect to spend the money to salt and shovel a snowy restaurant entrance area may find that they spend thousands more dollars defending themselves in a lawsuit brought by an individual who slipped and fell on the ice.

As an effective manager, the question to be considered is not whether costs are high or low. The question is whether costs are too high or too low, given management's view of the value it hopes to deliver to the guest and the goals of the foodservice operation's owners. Managers can eliminate nearly all costs by closing the operation's doors. Obviously, however, when you close the doors to expense, you close the doors to profits. Expenses, then, must be incurred, and they must be managed in a way that allows the operation to achieve its desired profit levels.

Some people assume that if a business purchases a product for $1.00 and sells it for $3.00, the profit generated equals $2.00. In fact, this is not true. As a business operator, you must realize that the difference between what you have paid for the goods you sell and the price at which you sell them does not represent your actual profit. Instead, all expenses, including advertising, the building housing your operation, management salaries, and the labor required to generate the sale, to name

but a few, are expenses that must be subtracted before you can determine your profits accurately.

Every foodservice operator is faced with the following profit-oriented formula:

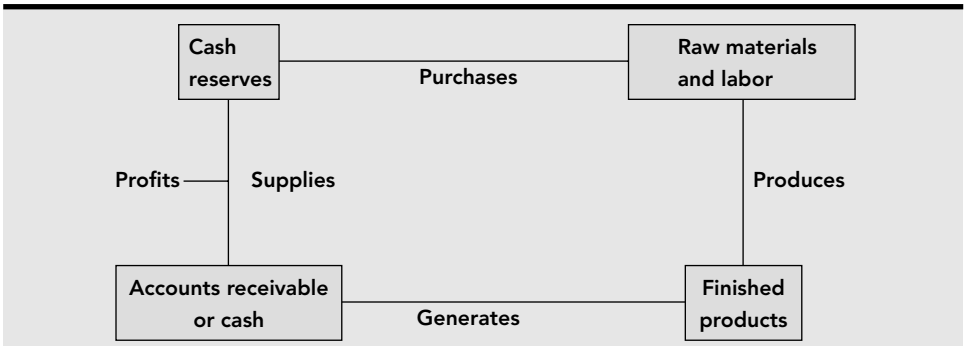
Revenue − Expenses = Profit

Thus, when you manage your facility, you will receive **revenue,** the money you take in, and you will incur **expenses,** the cost of the items required to operate the business. The dollars that remain after all expenses have been paid represent your **profit.** For the purposes of this book, the authors will use the following terms interchangeably: revenues and sales; expenses and costs.

This formula holds even in the "nonprofit" sector of foodservice management. For example, consider the situation of Hector Bentevina. Hector is the foodservice manager at the headquarters of a large corporation. Hector supplies the foodservice to a large group of office workers, each of whom is employed by the corporation that owns the facility Hector manages. In this situation, Hector's employer clearly does not have "profit" as its primary motive. In most **business dining** situations, food is provided as a service to the company's employees either as a no-cost (to the employee) benefit or at a greatly reduced price. In some cases, executive dining rooms may be operated for the convenience of management. In all cases, however, some provision for profit must be made. Figure 1.2 shows the flow of business for the typical foodservice operation. Note that profit must be taken out at some point in the process, or management is in a position of simply trading cash for cash.

In your own operation, if you find that revenue is less than or equal to real expense, with no reserve for the future, you will likely also find that there is no money for new equipment; needed equipment maintenance may not be performed; employee raises (as well as your own) may be few and far between; and, in general, the foodservice facility will become outdated due to a lack of funds needed to remodel and upgrade. The truth is, all foodservice operations need revenue in excess of expenses if they are to thrive. If you manage a foodservice operation in a profit

■ **FIGURE 1.2** Foodservice Business Flowchart



or a nonprofit setting, it will be your responsibility to communicate this message to your own staff.

Profit is the result of solid planning, sound management, and careful decision making. The purpose of this text is to give you the information and tools you need to make informed decisions with regard to managing your operation's revenue and expenses. If these tools are utilized properly, the potential for achieving profits you desire is greatly enhanced.

Profit should not be viewed as what is left over after the bills are paid. In fact, careful planning is necessary to earn a profit. In most cases, investors will not invest in businesses that do not generate enough profit to make their investment worthwhile. The restaurant business can be very profitable; however, there is no guarantee that an individual restaurant will in fact make a profit. Some restaurants do, while others do not. Because that is true, a more appropriate formula, which recognizes and rewards the business owner for the risk associated with business ownership or investment, is as follows:

Revenue − Desired Profit = Ideal Expense

Ideal expense, in this case, is defined as management's view of the correct or appropriate amount of expense necessary to generate a given quantity of revenue. **Desired profit** is defined as the profit that the owner wants to achieve on that predicted quantity of revenue. This formula clearly places profit as a reward for providing service, not a leftover. When foodservice managers deliver quality and value to their guests, anticipated revenue levels can be achieved and desired profit is attainable. Desired profit and ideal expense levels are not, however, easily achieved. It takes an astute foodservice operator to consistently make decisions that will maximize revenue while holding expenses to the ideal or appropriate amount. This book will help you to do just that.

■ REVENUE

To some degree, you can manage your revenue levels. Revenue dollars are the result of units sold. These units may consist of individual menu items, lunches, dinners, drinks, or any other item produced by your operation. Revenue varies with both the number of guests frequenting your business and the amount of money spent by each guest. You can increase revenue by increasing the number of guests you serve, by increasing the amount each guest spends, or by a combination of both approaches. Adding seating or drive-through windows, extending operating hours, and building additional foodservice units are all examples of management's efforts to increase the number of guests choosing to come to the restaurant or foodservice operation. Suggestive selling by service staff, creative menu pricing techniques, as well as discounts for very large purchases are all examples of efforts to increase the amount of money each guest spends.

It is the opinion of the authors that management's primary task is to take the steps necessary to bring guests to the foodservice operation. This is true because

the profit formula begins with revenue. Experienced foodservice operators know that increasing revenue through adding guests, suggestive selling, or possibly raising menu prices is an extremely effective way of increasing overall profitability, but *only* if effective cost management systems are in place.

The focus of this text is on managing and controlling expenses, not generating additional revenue. While the two topics are clearly related, they are different. Marketing efforts, restaurant design and site selection, employee training and food preparation methods are all critical links in the revenue-producing chain. No amount of effective expense control can solve the profit problems caused by inadequate revenue resulting from inferior food quality or service levels.

Leaders Are Readers!

One tool used by food service establishments to go beyond managing costs to increasing revenue is the menu. *Hospitality Marketing Management,* Fourth Edition, by Robert D. Reid and David C. Bojanic (ISBN: 0-471-47654-4) includes a thorough examination and discussion of how to increase food service revenue through the use of effective menu pricing strategy and creative menu layout and design. Read the last two chapters of this book.

What's an ISBN?

A book's International Standard Book Number (ISBN) is the unique identification number assigned to it upon its publication. Utilized worldwide, an ISBN is used (among other things) to look up books on the Internet and to identify specific books at bookstores. Where possible, we will identify suggested reading materials by an ISBN.

Effective cost control, however, when coupled with management's aggressive attitude toward meeting and exceeding guests' expectations, can result in outstanding revenue and profit performance.

FUN ON THE WEB!

www.restaurant.org. Click on "Industry Research," to see the National Restaurant Association's revenue projections for the over $500 billion dollar restaurant industry.

EXPENSES

There are four major foodservice expense categories that you must learn to control. They are:

1. Food costs
2. Beverage costs

3. Labor costs
4. Other expenses

FOOD COSTS

Food costs are the costs associated with actually producing the menu items a guest selects. They include the expense of meats, dairy, fruits, vegetables, and other categories of food items produced by the foodservice operation. When computing food costs, many operators include the cost of minor paper and plastic items, such as the paper wrappers used to wrap sandwiches. In most cases, food costs will make up the largest or second largest expense category you must learn to manage.

BEVERAGE COSTS

Beverage costs are those related to the sale of alcoholic beverages. It is interesting to note that it is common practice in the hospitality industry to consider beverage costs of a nonalcoholic nature as an expense in the food cost category. Thus, milk, tea, coffee, carbonated beverages, and other nonalcoholic beverage items are not generally considered a beverage cost. Alcoholic beverages accounted for in the beverage cost category include beer, wine, and liquor. This category may also include the costs of ingredients necessary to produce these drinks, such as cherries, lemons, olives, limes, mixers like carbonated beverages and juices, and other items commonly used in the production and service of alcoholic beverages.

LABOR COSTS

Labor costs include the cost of all employees necessary to run the business. This expense category would also include the amount of any taxes you are required to pay when you have employees on your payroll. Some operators find it helpful to include the cost of management in this category. Others prefer to place the cost of managers in the category of other expenses. In most operations labor costs are an operator's highest cost, or they are second only to food costs in total dollars spent. If management is included as a labor cost, then this category will frequently be even larger than the food cost category.

OTHER EXPENSES

Other expenses include all expenses that are neither food, nor beverage, nor labor. Examples include franchise fees, utilities, rent, linen, and such items as china, glassware, kitchen knives, and pots and pans. While this expense category is sometimes incorrectly referred to as "minor expenses," your ability to successfully control this expense area is especially critical to the overall profitability of your foodservice unit.

GETTING STARTED

Good managers learn to understand, control, and manage their expenses. Consider the case of Tabreshia Larson, the food and beverage director of the 200-room Renaud Hotel, located in a college town and built near an interstate highway. Tabreshia has just received her end-of-the-year operating reports for the current year. She is interested in comparing these results to those of the prior year. The numbers she received are shown in Figure 1.3.

Tabreshia is concerned, but she is not sure if she should be. Revenue is higher than last year, so she feels her guests must like the products and services they receive. In fact, repeat business from corporate meetings and special-events meals is really beginning to develop. Profits are greater than last year also, but Tabreshia has the uneasy feeling that things are not going as well as they could. The kitchen appears to run smoothly. The staff, however, often runs out of needed items, and there seems to be a large amount of leftover food thrown away on a regular basis. Sometimes, there seem to be too many staff members on the property; at other times, guests have to wait too long to get served. Tabreshia also feels that employee theft may be occurring, but she certainly doesn't have the time to watch every storage area within her operation. Tabreshia also senses that the hotel general manager, who is Tabreshia's boss, may be less than pleased with her department's performance. She would really like to get a handle on the problem (if there is one), but how and where should she start?

The answer for Tabreshia, and for you, if you want to develop a serious expense control system, is very simple. You start with basic mathematics skills that you must have to properly analyze your expenses. The mathematics required, and used in this text, consist only of addition, subtraction, multiplication, and division. These tools will be sufficient to build a cost control system that will help you professionally manage the expenses you incur.

What would it mean if a fellow foodservice manager told you that he spent $500 on food yesterday? Obviously, it means little unless you know more about his operation. Should he have spent $500 yesterday? Was that too much? Too little? Was it a "good" day? These questions raise a difficult problem. How can you equitably compare your expenses today with those of yesterday, or your foodservice unit with another, so that you can see how well you are doing? We know that

■ **FIGURE 1.3** Renaud Hotel Operating Results

	This Year	Last Year
Revenue	$1,106,040	$850,100
Expense	1,017,557	773,591
Profits	**88,483**	**76,509**

the value of dollars has changed over time. A restaurant with revenue of $1,000 per day in 1954 is very different from the same restaurant with daily revenue of $1,000 today. The value of the dollar today is quite different from what it was in 1954. Generally, inflation causes the purchasing power of a dollar today to be less than that of a dollar from a previous time period. While this concept of changing value is useful in the area of finance, it is vexing when one wants to answer the simple question, "Am I doing as well today as I was doing five years ago?"

Alternatively, consider the problem of a multiunit manager. Two units sell tacos on either side of a large city. One uses $500 worth of food products each day; the other unit uses $600 worth of food products each day. Does the second unit use an additional $100 worth of food each day because it has more guests or because it is less efficient in utilizing the food?

The answer to all of the preceding questions, and many more, can be determined if we use percentages to relate expenses incurred to revenue generated. Percentage calculations are important for at least two major reasons. First and foremost, percentages are the most common standard used for evaluating costs in the foodservice industry. Therefore, knowledge of what a percent is and how it is calculated is vital. Second, as a manager in the foodservice industry, you will be evaluated primarily on your ability to compute, analyze, and control these percent figures. While it is true that many basic management tools such as Microsoft Excel, Lotus, and other software programs will "compute" percentages for you, it is important that you understand what the percentages mean and how they should be interpreted. Percent calculations are used extensively in this text and are a cornerstone of any effective cost control system.

■ PERCENT REVIEW

Understanding percents and how they are mathematically computed is important. The following review may be helpful for some readers. If you thoroughly understand the percent concept, you may skip this section and the Computing Percent section and proceed directly to the Using Percent section.

Percent (%) means "out of each hundred." Thus, 10 percent would mean 10 out of each 100. If we asked how many guests would buy blueberry pie on a given day, and the answer is 10 percent, then 10 people out of each 100 we serve will select blueberry pie. If 52 percent of your employees are female, then 52 out of each 100 employees are female. If 15 percent of your employees will receive a raise this month, then 15 out of 100 employees will get their raise. Figure 1.4 shows three ways to write a percent.

COMMON FORM

In its common form, the % sign is used to express the percentage. If we say 10 percent, then we mean "10 out of each 100" and no further explanation is necessary. The common form, the percent, is equivalent to the same amount expressed in either the fraction or the decimal form.

■ **FIGURE 1.4 Forms of Expressing Percent**

	Percent		
Form	**1%**	**10%**	**100%**
Common	1%	10%	100%
Fraction	1/100	10/100	100/100
Decimal	0.01	0.10	1.00

FRACTION FORM

In fraction form, the percent is expressed as the part, or a portion of 100. Thus, 10 percent is written as 10 "over" 100 (10/100). This is simply another way of expressing the relationship between the part (10) and the whole (100).

DECIMAL FORM

A decimal is a number developed from the counting system we use. It is based on the fact that we count to 10 then start over again. In other words, each of our major units, 10s, 100s, 1,000s, and so on, are based on the use of 10s, and each number can easily be divided by 10. Instead of using the % sign, the decimal form uses the (.) or decimal point to express the percent relationship. Thus, 10 percent is expressed as 0.10 in decimal form. The numbers to the right of the decimal point express the percentage.

Each of these three methods of expressing percentages is used in the foodservice industry, and to be successful you must develop a clear understanding of how a percentage is computed. Once that is known, you can express the percentage in any form that is required or that is useful to you.

■ COMPUTING PERCENT

To determine what percent one number is of another number, divide the number that is the part by the number that is the whole. Usually, but not always, this means dividing the smaller number by the larger number. For example, assume that 840 guests were served during a banquet at your hotel; 420 of them asked for coffee with their meal. To find what percent of your guests ordered coffee, divide the part (420) by the whole (840).

The process looks as follows:

$$\frac{\text{Part}}{\text{Whole}} = \text{Percent} \quad \textit{or} \quad \frac{420}{840} = 0.50$$

Thus, 50% (common form), 50/100 (fraction form), or 0.50 (decimal form) represents the proportion of people at the banquet who ordered coffee. A large number of new foodservice managers have difficulty computing percent figures. It is easy to forget which number goes "on the top" and which number goes "on the bottom." In general, if you attempt to compute a percentage and get a whole number (a number larger than 1), either a mistake has been made or costs are extremely high!

Many people also become confused when converting from one form of percent to another. If that is a problem, remember the following conversion rules:

1. To convert from common form to decimal form, move the decimal two places to the left, that is, 50.00% = 0.50.
2. To convert from decimal form to common form, move the decimal two places to the right, that is, 0.40 = 40.00%.

In a restaurant, the "whole" is usually a revenue figure. Expenses and profits are the "parts," which are usually expressed in terms of a percent. It is interesting to note that, in the United States, the same system in use for our numbers is in use for our money. Each dime contains 10 pennies, each dollar contains 10 dimes, and so on. Thus when discussing money, it is true that a percent refers to "cents out of each dollar" as well as "out of each 100 dollars." When we say 10 percent of a dollar, we mean 10 cents, or "10 cents out of each dollar." Likewise, 25 percent of a dollar represents 25 cents, 50 percent of a dollar represents 50 cents, and 100 percent of a dollar represents $1.00.

Sometimes, when using percent to express the relationship between portions of a dollar and the whole, we find that the part is, indeed, larger than the whole. Figure 1.5 demonstrates the three possibilities that exist when computing a percentage. Great care must always be taken when computing percents, so that the percent arrived at is of help to you in your work and does not represent an error in mathematics.

■ USING PERCENT

Consider a restaurant that you are operating. Imagine that your revenues for a week are in the amount of $1,600. Expenses for the same week are $1,200. Given these

■ **FIGURE 1.5** Percent Computation

Possibilities	Examples	Results
Part is smaller than the whole	$\frac{61}{100} = 61\%$	Always less than 100%
Part is equal to the whole	$\frac{35}{35} = 100\%$	Always equals 100%
Part is larger than the whole	$\frac{125}{50} = 250\%$	Always greater than 100%

facts and the information presented earlier in this chapter, your profit formula for the week would look as follows:

Revenue − Expense = Profit

or

$1,600 − $1,200 = $400

If you had planned for a $500 profit for the week, you would have been "short." Using the alternative profit formula presented earlier, you would find:

Revenue − Desired Profit = Ideal Expense

or

$1,600 − $500 = $1,100

Note that expense in this example ($1,200) exceeds ideal expense ($1,100) and, thus, too little profit was achieved.

These numbers can also be expressed in terms of percent. If we want to know what percent of our revenue went to pay for our expenses, we would compute it as follows:

$$\frac{\text{Expense}}{\text{Revenue}} = \text{Expense \%}$$

or

$$\frac{\$1{,}200}{\$1{,}600} = 0.75, \text{ or } 75\%$$

Another way to state this relationship is to say that each dollar of revenue costs 75 cents to produce. Also, each revenue dollar taken in results in 25 cents profit:

$1.00 Revenue − $0.75 Expense = $0.25 Profit

As long as expense is smaller than revenue, some profit will be generated, even if it is not as much as you had planned. You can compute profit percent using the following formula:

$$\frac{\text{Profit}}{\text{Revenue}} = \text{Profit \%}$$

In our example:

$$\frac{\$400 \text{ Profit}}{\$1{,}600 \text{ Revenue}} = 25\% \text{ Profit}$$

We can compute what we had planned our profit percent to be by dividing desired profit ($500) by revenue ($1,600):

$$\frac{\$500 \text{ Desired Profit}}{\$1{,}600 \text{ Revenue}} = 31.25\% \text{ Desired Profit}$$

In simple terms, we had hoped to make 31.25 percent profit, but instead made only 25 percent profit. Excess costs could account for the difference. If these costs could be identified and corrected, we could perhaps achieve the desired profit percentage. Most foodservice operators compute many cost percentages, not just one. The major cost divisions used in foodservice are as follows:

1. Food and beverage cost
2. Labor cost
3. Other expense

A modified profit formula, therefore, looks as follows:

Revenue − (Food and Beverage Cost + Labor Cost + Other Expenses) = Profit

Put in another format, the equation looks as follows:

Revenue (100%)
− Food and Beverage Cost %
− Labor Cost %
− Other Expense %
= Profit %

Regardless of the approach used, foodservice managers must evaluate their expenses, and they use percents to do so.

UNDERSTANDING THE INCOME (PROFIT AND LOSS) STATEMENT

Consider Figure 1.6, an example from Pat's Steakhouse. All of Pat's expenses and profits can be computed as percents by using the revenue figure, $400,000, as the whole, with expenses and profit representing the parts as on the following page:

$$\frac{\text{Food and Beverage Cost}}{\text{Revenue}} = \text{Food Beverage Cost \%}$$

or

$$\frac{\$150{,}000}{\$400{,}000} = 37.50\%$$

$$\frac{\text{Labor Cost}}{\text{Revenue}} = \text{Labor Cost \%}$$

or

$$\frac{\$175{,}000}{\$400{,}000} = 43.75\%$$

$$\frac{\text{Other Expenses}}{\text{Revenue}} = \text{Other Expense \%}$$

or

$$\frac{\$25{,}000}{\$400{,}000} = 6.25\%$$

$$\frac{\text{Total Expense}}{\text{Revenue}} = \text{Total Expense \%}$$

or

$$\frac{\$350{,}000}{\$400{,}000} = 87.50\%$$

$$\frac{\text{Profit}}{\text{Revenue}} = \text{Profit \%}$$

or

$$\frac{\$50{,}000}{\$400{,}000} = 12.50\%$$

■ **FIGURE 1.6** Pat's Steakhouse

Revenue		$400,000
Expenses		
Food and Beverage Cost	$150,000	
Labor Cost	175,000	
Other Expense	25,000	
Total Expense		$350,000
Profit		**$ 50,000**

■ **FIGURE 1.7** Pat's Steakhouse P&L

Revenue		**$400,000**	**100%**
Food and Beverage Cost	$150,000	37.50%	
Labor Cost	175,000	43.75%	
Other Expense	25,000	6.25%	
Total Expense		**$350,000**	**87.50%**
Profit		**$ 50,000**	**12.50%**

An accounting tool that details revenue, expenses, and profit for a given period of time, is called the **income statement,** which is commonly called the **profit-and-loss statement (P&L).** It lists revenue, food and beverage cost, labor cost, and other expense. The P&L also identifies profits since, as you recall, profits are generated by the formula:

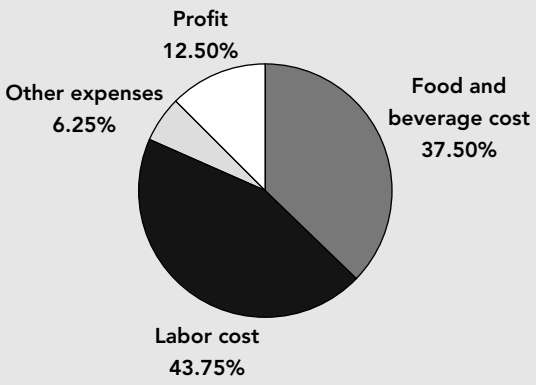
Revenue − Expense = Profit

Figure 1.7 is a simplified P&L statement for Pat's Steakhouse. Note the similarity to Figure 1.6. This time, however, expenses and profit are expressed in terms of both dollar amount and percent of revenue.

Another way of looking at Pat's P&L is shown in Figure 1.8. The pieces of the pie represent Pat's cost and profit categories. Costs and profit total 100 percent, which is equal to Pat's total revenues. To put it in another way, out of every revenue dollar that Pat generates, 100 percent is designated as either costs or profit.

Pat knows from the P&L that revenues represent 100 percent of the total dollars available to cover expenses and provide for a profit. Food and beverage cost

■ **FIGURE 1.8** Pat's Steakhouse Costs and Profit as a Percentage of Revenues



is 37.50 percent, and labor cost percentage in the steakhouse equals 43.75 percent. Other expense percentage equals 6.25 percent, and her total expense percent is 87.50 percent (37.50 + 43.75 + 6.25 = 87.50 percent). The steakhouse profit equals 12.50 percent. Thus, for each dollar in revenue, Pat earns a profit of 12.50 cents. Pat's revenue, expense, and profit information is contained in the steakhouse's P&L.

In restaurants that serve alcohol, food costs and beverage costs are most often separated into two categories in the P&L. Likewise, food revenues and beverage revenues are reported separately. This is done so that the food cost can be compared to food revenues, and the beverage cost can be compared to beverage revenues. Suppose, for example, that one manager is responsible for controlling food cost percent in the restaurant and another manager is responsible for controlling beverage cost percent in the bar. Separation of these two "departments," then, is especially helpful when evaluating the performance of these two managers. It also helps these managers to quickly identify and anticipate problems associated with their costs and identify ways to correct these problems.

The P&L is important because it indicates the efficiency and profitability of an operation. Because so many individuals and groups are interested in a food facility's performance, it is important that the P&L and other financial statements are prepared in a manner that is consistent with other facilities. If, for example, you own two Italian restaurants, it would be very confusing if one of your managers used a particular method for preparing his or her unit's P&L, while the other manager used an entirely different method. You, your investors, your accountant, governmental taxing entities, and your creditors may all be interested in your operational results, and unless you report and account for these in a manner they can easily understand, confusion may result.

To avoid such a set of circumstances, the **Uniform System of Accounts** is used to report financial results in most foodservice units. This system was created to ensure uniform reporting of financial results. A Uniform System of Accounts exists for restaurants, another for hotels, and another for clubs. The Uniform System of Accounts will be discussed in greater detail later in this text.

The primary purpose of preparing a P&L is to identify revenue, expenses, and profits for a given time period. As a manager, your efforts, more than any other factor, will influence your operation's profitability. Good managers provide excellent value to their guests, which cause guests to return, and thus increases revenue. In addition, good managers know how to analyze, manage, and control their costs. For these managers, expenses are held to the amount that was preplanned. The result is the desired profit level. Good managers influence the success of their units and their own employees. The results for them personally are promotions, added responsibilities, and salary increases. If you wish to succeed in the hospitality industry, it is important to remember that your performance will be evaluated primarily on your ability to achieve the profit levels your operation has planned for.

In addition to your own efforts, many factors influence profit dollars and profit percent, and you must be aware, and in control, of all of them. All of the factors that impact profit percent are discussed in later chapters of this text.

Fun on the Web!

www.restaurant.org. Link to "Industry Research," then "Reports" to see how you can get industry averages for P&Ls.

UNDERSTANDING THE BUDGET

Some foodservice managers do not generate revenue on a daily basis. Consider, for a moment, the foodservice manager at a summer camp run for children. In this case, parents pay a fixed fee to cover housing, activities, and meals for a set period of time. The foodservice director, in this situation, is just one of several managers who must share this revenue. If too many dollars are spent on providing housing or play activities, too few dollars may be available to provide an adequate quantity or quality of meals. On the other hand, if too many dollars are spent on providing foodservice, there may not be enough left to cover other needed expense areas. In a case like this, foodservice operators should prepare a budget. A **budget** is simply an estimate of projected revenue, expense, and profit. In some hospitality companies, the budget is known as **the plan,** referring to the fact that the budget details the operation's estimated, or "planned for," revenue and expense for a given accounting period. An **accounting period** is an hour, day, week, or month in which an operator wishes to analyze revenue and expenses.

All effective managers, whether in the commercial (for profit) or nonprofit sector, use budgets. Budgeting is simply planning for revenue, expense, and profit. If these items are planned for, you can determine how close your actual performance is to your plan or budget. In the summer camp example, the following information is known:

1. Number of campers: 180
2. Number of meals served to each camper per day: 3
3. Length of campers' stay: 7 days

With 180 campers eating 3 meals each day for 7 days, 3,780 meals will be served (180 campers × 3 meals per day × 7 days = 3,780 meals).

Generally, in a case such as the summer camp, the foodservice director is given a dollar amount that represents the allowed expense for each meal to be served. For example, if $1.85 per meal is the amount budgeted for this director, the total revenue budget would equal $6,993 ($1.85 per meal × 3,780 meals = $6,993).

From this figure, an expense budget can begin to be developed. In this case, we are interested in the amount of expenses budgeted and the amount actually spent on expenses. Equally important, we would be interested in the percent of the budget actually used, a concept known as **performance to budget.**

A simple example may help to firmly establish the idea of budget and performance to budget. Assume that a child has $1.00 per day to spend on candy. On Monday morning, the child's parents give the child $1.00 for each day of the week, or $7.00 total ($1.00 × 7 days = $7.00). If the child spends only $ 1.00 per day, he or she will be able to buy candy all week. If, however, too much is spent in any one day, there may not be any money left at the end of the week. Too ensure a week of candy eating, a good "candy purchasing" pattern could be created, such as the one in Figure 1.9. The "% of Total" column is computed by dividing $1.00 (the part) by $7.00 (the whole). Notice that we can determine the percent of total that should have been spent by any given day; that is, each day equals 14.28 percent, or 1/7 of the total.

This same logic applies to the foodservice operation. Figure 1.10 represents commonly used budget periods and their accompanying proportion amount.

Many foodservice operations are changing from "one month" budget periods to periods of 28 days. The **28-day-period approach** divides a year into 13 equal periods of 28 days each. Therefore, each period has four Mondays, four Tuesdays, four Wednesdays, and so on. This helps the manager compare performance from one period to the next without having to compensate for "extra days" in any one period. The downside of this approach is that you can no longer talk about the month of March, for example, because "period 3" would occur during part of February and part of March. Although using the 28-day-period approach takes a while to get used to, it is an effective way to measure performance and plan from period to period.

For example, in Camp Eureka, after one week's camping was completed, we found the results shown in Figure 1.11.

We can use the expense records from the previous summer as well as our solid industry knowledge and experience to develop expense budget figures for this summer. In this case, we are interested in both our plan (budget) and our actual performance. Figure 1.12 shows a performance-to-budget summary with revenue and

■ **FIGURE 1.9** Candy Purchases

Weekday	Budgeted Amount	% of Total
Monday	$1.00	14.28%
Tuesday	$1.00	14.28%
Wednesday	$1.00	14.28%
Thursday	$1.00	14.28%
Friday	$1.00	14.28%
Saturday	$1.00	14.28%
Sunday	$1.00	14.28%
Total	$7.00	100.00%

■ **FIGURE 1.10** Common Foodservice Budget Periods

Budget Period	Portion	% of Total
One week	One day	1/7 or 14.3%
Two-week period	One day	1/14 or 7.1%
	One week	1/2 or 50.0%
One month	One week	1/4 or 25.0%
28 days	One day	1/28 or 3.6%
30 days	One day	1/30 or 3.3%
31 days	One day	1/31 or 3.2%
Six months	One month	1/6 or 16.7%
One year	One day	1/365 or 0.3%
	One week	1/52 or 1.9%
	One month	1/12 or 8.3%

■ **FIGURE 1.11** Camp Eureka One-Week Budget

Item	Budget	Actual
Meals Served	3,780	3,700
Revenue	$6,993	$6,993
Food Expense	$2,600	$2,400
Labor Expense	$2,800	$2,900
Other Expense	$ 700	$ 965
Profit	$ 893	$ 728

■ **FIGURE 1.12** Camp Eureka Performance to Budget Summary

Item	Budget	Actual	% of Budget
Meals Served	3,780	3,700	97.9%
Revenue	$6,993	$6,993	100.0%
Food Expense	$2,600	$2,400	92.3%
Labor Expense	$2,800	$2,900	103.6%
Other Expense	$ 700	$ 965	137.9%
Total Expense	$6,100	$6,265	102.7%
Profit	$ 893	$ 728	81.5%

expenses presented in terms of both the budget amount and the actual amount. In all cases, percentages are used to compare actual expense with the budgeted amount, using the formula:

$$\frac{\text{Actual}}{\text{Budget}} = \%\ \text{of Budget}$$

In this example, revenue remained the same although some campers skipped (or slept through!) some of their meals. This is often the case when one fee or price buys a number of meals, whether they are eaten or not. In some other cases, managers will only receive revenue for meals actually served. This, of course, is true in a traditional restaurant setting. In either case, budgeted amount, actual expense, and the concept of percent of budget, or performance to budget, are important management tools. In looking at the Camp Eureka performance-to-budget summary, we can see that the manager served fewer meals than planned and, thus, spent less on food than estimated, but spent more on labor than originally thought necessary. In addition, much more was spent than estimated for other expenses (137.9 percent of the budgeted amount). As a result, the profit dollars were lower than planned. This manager has some problems, but they are not everywhere in the operation.

How do we know that? If our budget was accurate and we are within reasonable limits of our budget, we are said to be "in line," or in compliance, with our budget, because it is difficult to budget exact revenue and expenses. If, as management, we decided that plus (more than) or minus (less than) 10 percent of budget in each category would be considered in line, or acceptable, then an examination of Figure 1.12 shows we are in line with regard to meals served, food expense, labor expense, and total expense. We are not in line with other expenses because they were 137.9 percent of the amount originally planned. Thus, they far exceed the 10 percent variation that was reasonably allowed. Profit also was outside the acceptable boundary we established because it was only 81.5 percent of the amount budgeted. Note that figures over 100 percent mean too much (other expense), while figures below 100 percent mean too little (profit).

Many operators use the concept of "significant" variation to determine whether a cost control problem exists. In this case, a significant variation is any variation in expected costs that management feels is an area of concern. This variation can be caused by costs that were either higher or lower than the amount originally budgeted or planned for.

When you manage a foodservice operation and you find that significant variations from your planned results occur, you must:

1. Identify the problem.
2. Determine the cause.
3. Take corrective action.

It is crucial to know the kind of problem you have if you are to be an effective problem solver. Management's attention must be focused on the proper place. In this case, the proper areas for concern are other expense and profit. If, in the future, food expense became too low, it, too, would be an area of concern. Why? Remember that

expenses create revenue; thus, it is not your goal to eliminate expense. In fact, those managers who focus too much on eliminating expense, instead of building revenue, often find that their expenses are completely eliminated when they are forced to close their operation's doors permanently because guests did not feel they received good value for the money spent at that restaurant! Control and management of revenue and expense are important. Elimination of either is not desired.

As you have seen, revenue and expense directly impact profit. Your important role as a hospitality manager is to analyze, manage, and control your costs so that you achieve planned results. It can be done, and it can be fun.

The remainder of this text discusses how you can best manage and account for foodservice revenue and expense. With a good understanding of the relationship among revenue, expense, and profit, and your ability to analyze using percentages, you are ready to begin the cost control and cost management process.

Technology Tools

Most hospitality managers would agree that an accurate and timely income statement (P&L statement) is an invaluable aid to their management efforts. There are a variety of software programs on the market that can be used to develop this statement for you. You simply fill in the revenue and expense portions of the program, and a P&L is produced. Variations include programs that compare your actual results to budgeted figures or forecasts, to prior-month performance, or to prior-year performance. In addition, P&Ls can be produced for any time period, including months, quarters, or years. Most income statement programs will have a budgeting feature and the ability to maintain historical sales and cost records. Some of these have been developed specifically for restaurants, but cost-effective generic products are also available.

A second issue, and one that must be kept foremost in mind, is that of information accessibility. An executive chef, for example, would certainly need to have information on food cost available to him or her. At the same time, it may not be wise to allow servers or cooks access to payroll information about others that, while it certainly affects costs, should only be shared with those who need to know. Thus, as you examine (in this chapter and others) the cost control technology tools available to you, keep in mind that not all information should be accessible to all parties, and that security of your cost and customer information can be just as critical as accuracy.

Also, don't forget that to effectively manage your overall operation you will need to communicate with employees, guests, and vendors. Thus, the software you will need includes office products for word processing, spreadsheet building, faxes, and e-mail.

Fun on the Web!

Peachtree creates a variety of accounting software programs that will help you create a monthly Income (P&L) statement and do much more. To view their product offerings go to: **www.peachtree.com.** Click on "Which product is right for me?" under the Future Customers heading, to see the features available in their newest releases.

Apply What You Have Learned

Jennifer Caratini has recently accepted the job as the Foodservice Director for Techmar Industries, a corporation with 1,000 employees. As Foodservice Director, Jennifer's role is to operate a company cafeteria, serving 800 to 900 meals per day, as well as an Executive Dining room, serving 100 to 200 meals per day. All of the meals are provided "free of charge" to the employees of Techmar. One of Jennifer's first jobs is to prepare a budget for next year's operations.

1. In addition to food products and foodservice employees, what are other expenses Techmar will incur by providing free meals to its employees?
2. Since employees do not pay for their food directly, what will Jennifer use as the "revenue" portion of her budget? How do you think this number should be determined?
3. In addition to her know-how as a foodservice manager, what skills will Jennifer need as she interacts with the executives at Techmar who must approve her budget?

Key Terms and Concepts

The following are terms and concepts discussed in the chapter that are important for you as a manager. To help you review, please define the terms below:

Revenue
Expense
Profit
Business dining
Ideal expense
Desired profit
Food costs
Beverage costs
Labor costs
Other expenses
Percent
Income statement
Profit and loss statement (P&L)
Uniform System of Accounts
Budget/Plan
Accounting period
Performance to budget
28-day-period approach

Test Your Skills

1. At the conclusion of her first month of operating Val's Donut Shop, Val computed the following revenue and expense figures:

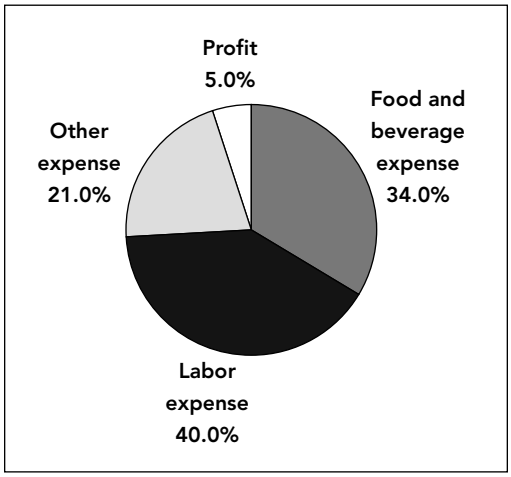
Week	Revenue	Expense	Profit/Loss
1	$ 894.50	$ 761.80	
2	1,147.60	522.46	
3	1,261.80	879.14	
4	1,345.11	1,486.20	
Month			
To Receive $1,200.00 Profit for the Month			
Month			

Prepare both weekly and monthly profit formulas so that Val has a good idea about her current profit situation. Also, given her sales for the month, tell her how much her ideal expense should have been to realize her desired profit of $1,200.

2. Su Chan manages a Chinese restaurant called the Bungalow. Her P&L for the month of March is as follows:

The Bungalow's March P&L		
Revenue	$100,000.00	100.0%
F&B Expense	34,000.00	34.0%
Labor Expense	40,000.00	40.0%
Other Expense	21,000.00	21.0%
Total Expense	95,000.00	95.0%
Profit	5,000.00	5.0%

Su has a meeting with the owner of the Bungalow next week, so she decided to create a pie chart showing the percentage of her costs in relation to her total sales (see the following diagram).



At the meeting with the owner, Su is asked to change the information on the pie chart to reflect next month's projections. The owner suggests that April revenues and costs should be as follows:

April revenues = $120,000.
Food and beverage expense = $44,000.
Labor and other expenses remain constant.

Using these numbers, is the owner's profit percentage going to be higher or lower than that in March? By how much?

After looking at the owner's projections, she thinks it might be too difficult (and not so good for her guests) if she cannot increase labor costs along with sales. She proposes a compromise and tells the owner that if he will agree to increase labor costs, she will try to decrease other expenses. So, Su proposes the following:

April revenues = $120,000.
Food and beverage expense = $44,000.
Labor expense = $50,000.
Other expense = $19,000.

Using these numbers, is the owner's profit percentage going to be higher or lower than that in March? By how much?

Which set of projections has more reasonable goals?

Note: If you use the Excel spreadsheets on your student disk, the changes you make to the numbers should be reflected on the pie charts as well.

3. The dining room at the Roadrock Inn is extremely popular. Terry Ray, the food and beverage director, is pleased to see that his revenue is higher than last year. Of course, expenses are higher also. Express Terry's expenses and profit as a percentage of total revenue, both this year and last year (fill in all empty blanks).

	This Year	%	Last Year	%
Revenue	$965,971.00		$875,421.00	
F&B Expense	367,069.00		350,168.00	
Labor Expense	338,090.00		315,151.00	
Other Expense	144,896.00		140,068.00	
Total Expense				
Profit				

How is Terry doing in managing his expenses when comparing this year to last year? How do changes in revenue affect his performance?

4. Pamela Cantu operates a school foodservice department in a small, rural community. She feeds approximately 1,000 students per day in three different locations. She receives an average of $1.20 in revenues per meal. Her budget, set at the beginning of the school year by the superintendent, is developed in such a way that a small amount is to be reserved for future equipment purchases and dining room renovation. These funds are available, however, only if Pamela meets her budget. She hopes to use this year's reserve (profit) to buy a $5,000 refrigerated salad bar for the high school. Since it is the midpoint of her school year, help her determine her "performance to budget" (fill in all empty blanks).

Item	Budget	Actual	% of Budget
Meals Served	300,000	149,800	
Revenue			
Food Expense	$170,000	$ 84,961	
Labor Expense	125,000	63,752	
Other Expense	60,000	31,460	
Total Expense	355,000		
Reserve	5,000		

Assuming that the year is 50 percent completed and Pamela continues doing what she is doing, is she likely to meet the reserve requirement and, thus, be able to purchase the salad bar by the end of the year? If not, what changes should she make over the next six months to ensure that she will have the $5,000 in reserve?

5. Sam Guild operates a dining room reserved for doctors in a large hospital in the Northeast. Sam's boss has given Sam a target of a 33 percent food cost but has indicated that the target may be adjusted. Currently, the doctors' meals sell for $15.00. Sam knows he currently can spend $4.95 for the food required to produce each meal. Fill out the chart below to help Sam find out how much he will be able to spend on each meal at various food cost percent levels if his boss adjusts his target.

Meal Selling Price	Food Cost %	Amount That Can Be Spent for Food
$15.00	20%	
$15.00	25%	
$15.00	30%	
$15.00	33%	$4.95
$15.00	35%	
$15.00	40%	

How will the doctors' meals likely be affected if the target cost percentage is reduced? What if it is increased?

6. Dawne Juan is the Food and Beverage Director for a mid-size hotel in a beach destination area. The General Manager of the hotel has given Dawne a target of 10 percent profit for this year. Dawne's staff is predominately her beach buddies. Although she is good at controlling most of her costs, she has a hard time telling her friends to go home when business slows down and she needs to reduce her staff. If she doesn't make her profit goal, her general manager will likely reprimand her, and she could possibly lose her job. Express Dawne's expenses and profit as a percentage of total revenue, both this year and last year, to determine if she met her profit goal (fill in all empty blanks).

	This Year	%	Last Year	%
Revenue	$1,448,956		$1,094,276	
F&B Expense	463,666			35%
Labor Expense	652,030			40%
Other Expense		15%	186,027	
Total Expense				
Profit				8%

Was Dawne effective at controlling her expenses? Did she meet the profit goal set by the General Manager? If not, what could Dawne do in the future to help her make her target profit.