

# brandStrategy Presentation To IBBASA 6 August 2010

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## **Introduction**

Since 2004, brandStrategy has been asking, developing, creating and communicating unique strategic interventions that connect organisations to their staff and their staff to their customers.

Our diverse offerings – from once-off project consultations to full assessments and implementations of brand strategies – sets us apart from our competitors. Moreover, a combination of knowledge, disparate skills and expertise enables us to offer services such as research, focus groups, fact finding, corporate vision & ID, integrated marketing strategies, website development and design, print and electronic design, branding, coaching, training, email campaigns, public speaking, and restaurant & business consulting.

We are able to assist you in developing a complete on-line presence from website through social media marketing.

We are a Johannesburg based company but travel extensively throughout South Africa, Africa and internationally when necessary.

For more information on brandStrategy and to view our services and extensive client list, please visits [www.brandstrategy.co.za](http://www.brandstrategy.co.za)

## Who is Killing the South African Restaurant Industry

It was the **landlord** in the shopping center with a lease agreement

It was the **customer** in the store with no spending power

It was the **staff** in the restaurant with no concept of their actions

It was the **supplier** in his counting house with no understanding of his customer

It was the **franchisor** in his office with no consideration for the bottom line

It was the **owner** in la-la land with no clue what she was doing

## Profit what profit?

Sales Range : 0.5 Million Plus			
R500K +			
%	Item	Variable	Non Variable
100.00	Net Revenue	■	
36.00	Cost of Sales	■	
64.00	Gross Profit	■	
49.34	Operating Expenditure	■	
11.00	Occupancy Costs		■
19.58	Salaries and wages		■
6.00	Management Service Fee	■	
2.00	Marketing Fee	■	
0.13	Loyalty Fee		■
0.50	Administration		■
1.20	Bank Charges		■
0.00	Consumables		■
1.00	Cleaning Materials		■
1.30	Repair & Maintenance		■
1.20	Replacements		■
1.00	General		■
0.65	Insurance		■
3.60	Utilities	■	
14.66	Retention	■	

3.6 Million to 6 Million			
R1-500K			
%	Item	Variable	Non Variable
100.00	Net Revenue	■	
37.00	Cost of Sales	■	
64.00	Gross Profit	■	
52.34	Operating Expenditure	■	
11.50	Occupancy Costs		■
22.06	Salaries and wages		■
6.00	Management Service Fee	■	
2.00	Marketing Fee	■	
0.13	Loyalty Fee		■
0.50	Administration		■
1.20	Bank Charges		■
0.00	Consumables		■
1.00	Cleaning Materials		■
1.30	Repair & Maintenance		■
1.20	Replacements		■
1.00	General		■
0.65	Insurance		■
3.80	Utilities	■	
10.66	Retention	■	

## 10 Common Restaurant Startup Mistakes (and how to avoid them)

In any new business venture good decision-making is vital. Opening a new restaurant requires so many decisions that it's not hard to make some bloopers along the way.

The key is not totally missing the mark on the really important issues that can make or break your chances for success. Here are some of the more important common missteps new owners make in areas that play a big role in how well a new restaurant is likely to do.

1. **Underestimating capital needs.** There are many good new restaurants with excellent prospects for success that simply run out of money. It's common for first time owners in particular, to leave out or inadequately project all the startup costs involved in opening the restaurant. Some of the reasons include construction overruns, change orders, delays, and to be blind-sided by additional costs mandated from local inspectors and building authorities.

Also, soft costs like permits, liquor licenses, insurance binders and pre-opening payroll are often missed completely or grossly under-budgeted. Unless you've done it before, it's usually advisable to seek some experienced, professional help in identifying and estimating, in detail, startup capital you'll need. Even then, many pros still add a 10%-15% contingency for the host of things that can (and often do) happen to add more cost to the project than

you plan on.

2. **Believing you'll start making money on opening day.** The odds are stacked against this happening. Even the best run chain restaurants, who open restaurants for a living, factor into their startup budgets, an allowance for funding operating deficits for up to 2 to 3 months after the restaurant opens.

It usually takes time to build sales volume to an adequate level. Even if your sales are strong from day 1, food and labor costs are usually sky high for the first several weeks as your managers and staff get acclimated, productive and have the time and energy to focus on anything other than just taking care of who's at the table. In time, most things can be fixed. Run out of money and you're done. Not factoring in an adequate reserve for initial operating deficits is another cause of undercapitalization (see #1 above).

3. **Lack of a clear vision and purpose.** This may sound somewhat vague and intangible but a successful startup requires the coordinated effort of a dedicated staff pulling together in the same direction, united by a common goal. Getting this accomplished requires some leadership skills.

New operators who either don't have or can't communicate an underlying mission that the staff can rally around will find it difficult to create the kind of climate that supports teamwork, hard work and dedication to excellence that endures through the long hours and sometime chaotic conditions that take place during the startup phase of any new restaurant.

4. **Lack of documented systems, procedures and training manuals.** Restaurant operations involves the ongoing repetition of hundreds and even thousands of divergent tasks by many individuals and groups of individuals. Organization and consistent execution is key to creating a successful restaurant. Franchised restaurants start out with detailed recipes, checklists and procedures to do everything from prepping the lettuce, to cleaning the restrooms to closing out the cashier. In new independent restaurants, it's often make it up as you go.

There may be nothing to go by other than what's in the owner's head. This makes it more challenging to train employees and execute consistently so customers get a consistent level of service and food quality regardless of the server is or who's in the kitchen. The longer the restaurant operates without a documented way of doing business, the longer the restaurant stays stuck in the often unorganized and do-what-it-takes and difficult startup phase.

5. **Owner fails to function like an owner.** Instead, the owner functions like a just another employee and ends up bussing tables, cooking in the kitchen and doing the books. Obviously this is often a necessity during the startup phase but eventually someone has to manage the business, not just run the restaurant.

Managing the business includes activities like monitoring cash flow, analyzing the P&L, deciding about next month's marketing activities, evaluating what's working on the menu and other "strategic" functions to position the restaurant for future success. If the owner is constantly training employees or working the line, guess who's managing the business? Nobody.

6. **Having the grand opening on opening day.** You only have to do this once and you learn to wait a month or 2 to declare your grand opening. There are few things worse than getting

slammed with more business that you can possibly handle on day one. With so many restaurants, the public's first impression can easily be their last.

Blow it on opening day and chances are you won't see most of those people again, ever. And they'll tell their friends to stay away too. Soft, quiet openings are the way to go. Get your act together before you tell the world.

7. **Focusing too much on what you like.** What you like doesn't matter, because you are not the customer. What matters is what your customers like. Find out what people in your area want and the price they're willing to pay for it. Go to existing restaurants and find out what people are buying. Take formal or informal surveys, conduct focus groups, anything to get a sense of what people in your area are hungry for that they currently can't get in your market area and what they're willing to pay for it. Too many new restaurant concepts miss the mark by not analyzing what people want in their local market.
8. **Deciding on a concept, then finding a location.** Restaurant industry legend Phil Romono, whose biggest creations are Fuddruckers and Macaroni Grill (both national chains now) says that's a mistake. Don't marry yourself to a concept. Find a location in a good market with adequate parking, access, visibility and other positive traits, then determine what the local market wants that it can't get and find a way to satisfy that unfilled desire.
9. **Accepting a secondary location to save on rent.** Don't be too sure that your restaurant is going to be so exceptional that customers will go out of their way to find you. With all the restaurants there are today, chances are they won't. High visibility and convenient access are more critical today than ever. Saving money on rent in a poor location often results in spending all that and more on advertising in an attempt to get noticed and bring in more business.
10. **Trying to appeal to everyone.** You can't and if you try you'll end up with too many items on the menu, an overly complicated kitchen, confused customers and no unique identity in the marketplace. The key to success for today's independents is to identify an unfilled niche in your local market and being laser-beam focused on filling that particular slice of the market. This will give you a much better chance to become really good at whatever it is you do.

## 10 Restaurant Financial Red Flags

After 16 years in the restaurant industry, six as an independent owner/operator and the last two as a consultant, I have experienced and observed just about every type of financial problem imaginable. As all restaurant veterans already know, this is a business that is very unforgiving when it comes to achieving bottom line profits. Not only is there little room for financial management missteps, the problem is compounded by the lack of business experience and basic financial skills that most startup restaurateurs bring to the table.

Unlike many other small business' that employ full or part time financial personnel, most restaurant owners cannot afford that luxury, and spend their days jumping from one operational task (or crisis)

to another with the financial management of the restaurant not receiving the attention that it requires.

**UNFORTUNATELY...** No amount of consulting support or improved financial skills and procedures can solve a restaurant's financial problems if they result from inadequate sales. Therefore, we will focus on those red flags that hopefully can be corrected by the improved procedures or management of your existing revenues, or at worst, by helping to quantify the additional revenues that will be required.

*Before I even begin to explain the red flags, here's a quick punt for one of my favourite clients (who just happens to be my brother!) Together we have developed Ideal Stock Control, a back office system that operates independently of or in conjunction with your POS. It helps ensure profitability and helps close those holes through which THOUSANDS of Rands seep away. Visit <http://www.idealstockcontrol.com/> for more details.*

### **Absence of a well organized and implemented accounting system.**

The first and most important piece of information needed when evaluating the financial health of a restaurant is a copy of its accounting software file (most typically a QuickBooks backup file). Printed copies of basic financial statements (Profit & Loss and Balance Sheet) are not adequate for this task because they do not verify the accuracy of the numbers presented. Only by reviewing how all the financial transactions are actually "posted" to the General Ledger can one determine the degree of accuracy of the numbers produced. Since you cannot manage what you cannot count, a restaurant whose accounting system (or lack thereof) is not properly setup and/or implemented most often results in the restaurant owner "flying blind"

Since all the other "Red Flags" discussed in this article cannot be accurately identified or evaluated if the accounting system is not setup and implemented properly this task should be the restaurant owner's primary concern if he or she desires to create a viable business. Make sure to have the support of an accountant or restaurant financial consultant before you open to insure that you give yourself a chance to succeed. If you are already open and suspect that your accounting system is in need of first aid, then do yourself a favor and get some help as soon as possible. As I said earlier, I have rarely seen a financially successful restaurant that did not have its accounting and financial controls in order.

### **Key operating expenses too high relative to gross sales.**

Restaurant food & beverage purchases plus labor expenses (wages plus employer paid taxes and benefits) account for 55 to 60 cents of every Rand in restaurant sales. The combined total of these two cost categories, referred to as your restaurant's "Prime Cost", are where the battle for restaurant profitability is truly waged. This is not simply because they represent the largest percentage of your total expenses, but also because you have the ability to control them. Unlike utility and insurance expenses that are relatively fixed, you can directly impact your food cost percentage by more effective purchasing, product handling and menu pricing. Similarly, hiring practices, scheduling, and even the layout of your kitchen and the way your menu items are selected can favorably impact labor costs.

The bottom line is this, when I see a restaurant's Prime Cost percentage exceed 60%, a red flag is raised. Unless the restaurant can compensate for these higher costs by having, for example, a very favorable rent expense (e.g. less than 8% of sales) it is very difficult, and perhaps impossible, to be profitable. While we are on the subject of rent expense it is useful to point out that on a national basis a restaurant's occupancy expense is the single highest expense after its "Prime Costs", and averages around 9% of sales. As a fixed expense the only way that you can reduce this ratio is to increase sales. When I see this number exceeding 9% of sales another red flag is raised.

**Menu items not accurately documented, costed and updated.**

The most common method of menu item pricing that I have observed over the years is what I will call the comparative approach. Simply check a few other restaurants that you compete with, find a similar item on their menu, and then price your item accordingly. Now it's one thing to document and cost out all your menu items and then to determine what your selling price will be by taking into account that of your competitors, but it's quite another to price solely off of them. The truth is that it takes a lot of discipline and time to carefully and accurately document and cost (and re-cost periodically as your supplier prices change) your menu items.

Moreover, you need to be well organized, and have some reasonable math aptitude to deal with detail required to convert product prices from the way you purchase them to recipe units for costing purposes. But how can you possibly manage your restaurant's food costs if you do not even know what each and every item is costing you? All you are left with is the "Let's raise the price" mentality. And while that may work in the short run, there are unquestionably better ways to proactively manage your food costs than that!

There are a variety of recipe costing software products on the market, but they are of no value if you are not committed to first learning how to use them and then to maintain them day in and out. *Once again you can always check out <http://www.idealstockcontrol.com/>*

**Food & beverage inventory levels not counted and costed at the end of each accounting period or recorded in your accounting software.**

Most independent restaurant operators confuse their monthly food and beverage purchases with their monthly usage. By this I mean that they review their monthly P&L (Profit and Loss) and assume that the food purchased during the month divided by the food sales for the same period equals the cost of goods sold for food!

Not so. Without knowledge of the beginning and ending inventories you can never calculate an accurate food cost. For a restaurant with food sales of R500,000/month, an inventory difference of R20,000 between the beginning and end of the month, can translate into a variance of 5%. You simply cannot manage your food costs if you do not know what they are, and you cannot know what they are if you do not count and record your inventory variances.

**Food and beverage inventory levels too high relative to corresponding sales.**

This red flag is not as obvious as some of the others but can be just as serious an obstacle to your restaurants profitability. A restaurant that carries too much food inventory will inevitably have higher food costs than it would otherwise. Too much food sitting in your walk-in fridge, your freezer and your dry goods shelves will result in excess waste, over-portioning, reduced product utilisation, theft and will also tie up your most valuable asset....cash!

But how do you determine how much inventory is too much or what the ideal amount of inventory is? A typical full service restaurant should have on average no more than 7 days of inventory (that number can be reduced by a few days for quick service restaurants).

#### **Daily & weekly financial operating data not collected, reviewed or acted upon.**

If you want to be financially successful as an independent restaurant operator you need to be more like the chains when it comes to proactive management of your business. Every chain restaurant generates some type of daily and weekly report that summarizes, in a simple and easy to view format, all the key daily and weekly operating data including sales (by category), labor (by department), food and beverage purchases as well as beginning and ending inventories, and other fixed expenses allocated on a daily basis to produce a weekly estimate of the restaurant's net profit.

You do not have the luxury of an IT staff like the chains to create these systems, but with some discipline you can collect this information and use it to identify problems as they happen. It is very difficult to make the corrections that are needed in your employee scheduling and product purchasing when all you have to go on is a monthly P&L that is not available to you till the middle of the following month. These corrections need to be made immediately when you have a clear understanding of what scheduling and purchasing decisions were made (or not) that produced the results that you attempting to improve upon.

The good news is that all the information that you need is readily available to you from your daily POS reports and supplier invoices. Use an Excel spreadsheet to organize this information and present it to key managers in the restaurant so they can be held accountable

#### **Inaccurate posting of financial information to your accounting system.**

One of the most common errors found when reviewing a restaurant's accounting procedures is that many different types of financial entries are posted to the wrong accounts. This results in financial reports that are both inaccurate and misleading.

Some of the most common errors I see are a restaurant's daily cash and credit receipts being recorded as income, no recognition of discounts or complimentary meals, inaccurate posting of VAT, gift certificate sold recorded as revenue and not as a liability, employee wages and employer paid payroll combined as wages, recording capital expenses as ordinary expenses. Granted, these transactions are most likely not easily comprehended by the typical independent owner.

That is why it's so important to seek professional financial help in making sure that your accounting system is setup properly from the start. If you are "flying blind" your chances of financial success will

be greatly diminished, and if you cannot make a reasonable profit then all your efforts at producing a great dining experience for you customers will be irrelevant.

**Current liabilities sufficiently greater than current assets as to impair future ability to pay bills.**

After recording all your weekly sales and invoices, go to your Balance Sheet and divide your current assets (e.g. cash, credit card receipts in transit, accounts receivable, food and beverage inventories) by your current liabilities (e.g. invoices, VAT, lease payments and short term loans due). Using the following example:

Current Assets= R100 000

Current Liabilities = R90 000

Current Ratio =  $R100000/R90000 = 1.11$

This means that there is R1.11 of current assets for every R1.00 of current liabilities and is a rough measure of your ability to pay your outstanding bills. In most industries a ratio of 1:1 is considered to be reasonable. Restaurants typically have lower ratios because they maintain relatively small inventory levels combined with a quick cash turnover (meals are paid for the same day as they are served).

Well-established and professionally run restaurants will typically have ratios over 1:1. Younger and less established restaurants will almost always be below 1:1. If your ratio is below .7:1 than you should be concerned. While restaurants can survive for long periods with lower ratios than this, it does typically indicate that without an increase in either sales or working capital that you and your business are looking to rocky times ahead.

**Owner relying on online bank balance to determine available cash to pay bills.**

This is an easy red flag to spot, and indicates to me either the lack of a properly functioning accounting system or a basic financial misunderstanding of how to manage cash flow. Here is the reason why. Your online balance tells you how much cash you have at that moment of time only. It does not account for previously written checks that have not yet cleared your account or for cash or credit card deposits “in transit”.

You need to confidently rely on your Balance Sheet to tell you how much cash you have in your bank account, and this means that you need to accurately record all your sales and corresponding deposits as well as all your bills and corresponding payments on a timely basis.

**Overall lack of understanding as to how to read and interpret period ending Financial Statements.**

Aside from not having a well organized and implemented accounting system in place (Red Flag #1), the most serious financial red flag that I observe is the typical independent restaurant owners lack of understanding how to read and interpret the three fundamental financial reports readily available by all accounting software programs:

- 1) Profit and Loss Statement
- 2) Balance Sheet

### 3) Statement of Cash Flow

I cannot possibly do justice to this topic here, but it is critical to point out the importance to all new and existing owners of obtaining the basic financial skills that will be required for you to succeed. Get some help from your accountant, hire a consultant, take an accounting course, bring in a friend with the necessary skills, just make sure to do something. While I must admit that I have had some clients over the years that succeed in spite of themselves, this is the exception. To be successful in this business as an independent operator you need to make sure that your financial skills are the equal of your culinary and management skills. Without all three skills working in tandem you are not giving yourself the opportunity to succeed that you deserve.

#### **There Is Blood on the Streets**

No one is really sure who coined the phrase but some say it was Baron Rothschild, the scion of the Rothschild banking family. What it means is that when fear is at its highest, one must toss aside the bearish feeling and turn bullish. Excellent when you have a couple of billion in the bank or are using someone else's money!

Everyday my inbox is filled with letters from desperate restaurant owners trying to save their businesses, inside information on franchise units that are closing down around the country and equally surprising the number of BIG NUMBER stores opening up. Don't believe me? Rumour has it that the set up costs of five restaurants situated at the new Melrose Arch range between R2 million and R12 million. In other words a staggering R29 million was spent on the set up of FIVE restaurants. Using a simple formula of assuming they would like to achieve a payback in 36 months, they would need to generate a combined profit of R805 000 a month for the next 3 years.

Given that most restaurants are not achieving anything more than a 15% net profit, that is a staggering R5 366 000 turnover EVERY month between them. Want to drill those numbers down a little further? Looking at the varied mix of the restaurants involved, let's give them the benefit of the doubt and assume that their customers are spending an average of R200 each.

Great news! They only need 26830 customers EVERY MONTH to achieve this... This is not rocket science, and if I have erred on the low side when it comes to net profit or spend per head this only makes the scenario fractionally less frightening. I called my mate Nick the other day from Melrose Arch and told him that these people have "more BUCKS, more BRAINS and certainly more BALLS" than me! I used to think I understood the restaurant industry, CLEARLY NOT!

If there are casualties (and I have a prediction list that I will not share) who is to blame? We need to remember that these leases were signed when things were good and there was "Cash on the Streets" but somebody, somewhere didn't do the math. Landlords, Franchisors, Letting Agents, Consultants, Naive Operators? Take your pick, the blame lies somewhere there. An industry insider told me the other day that every restaurant landlord should have a pimp for a brother because even restaurant landlords need someone they can look up to.

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