Budgeting is often the overlooked part of restaurant management. Many restaurateurs do not look forward to preparing a yearly budget. But it doesn't have to be a dreaded process as we will demonstrate with this step-by-step approach.

A budget is a financial plan designed to forecast the sales your restaurant can achieve and the expenses required to achieve those sales.

There are three distinct phases of budgeting, each one deriving information from the one before.

1. The evaluation phase. The evaluation phase makes sense of your restaurants past performance and identifies those factors that may influence the future.

2. The planning phase. The planning phase uses the information complied during the evaluation to forecast the budget.

3. The control phase. The control phase uses the budget cost during planning to keep track of monthly performance.

The evaluation phase

During the evaluation phase you analyze both the external factors (outside your control) that influence the restaurant's business and the internal factors (within your control) that determine the future performance of your restaurant.

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The external factors include your sales generators, competition, community events and your local economy. You must also include other items that may affect the expense side of your financial statement, such as actions by your local government, road repair, and zoning changes. Even though you have little control over these items, you nevertheless have to take them into account when preparing your budget.

The most important factors are your restaurant's sales generators. Sales generators are office buildings, residential areas, schools, and any other business or gathering of people that may generate sales for your restaurant. Visit your local chamber of commerce and city planning commission to learn of any new developments, such as office buildings that may be in the planning stages. Once you have identified the sales generators you should then categorize them by special characteristics, such as age groups, estimated income levels, in-house eating facilities, and hours of operation. This information can then be used as a reference when you develop your budget.

Evaluate your competitors

The second step of the external process is to analyze your restaurant's competitors. What your competitors do will greatly affect your restaurant's sales. Visit each competitor and obtain the answers to the following questions:

1. What are the prices of your competitor's menu items, and how do they compare to your

restaurant? If you competitors are charging higher prices for similar items, you may be able to increase your prices and increase your revenues. This, of course, may also cause your guest counts to decrease.

2. What portion sizes are being served? Based on these observations you can determine whether your portion sizes are appropriate. You may discover that your portion sizes are lager than your competitors. You may choose to cut back on your portion size as a marketing advantage.

3. What types of marketing strategies are competitive restaurants undertaking? You should regularly read newspapers and monitor other media, such as radio, to gain insight into your competitors' marketing strategies and determine if your own marketing budget is adequate.

4. What is unique about your competitors' restaurants? Trying to ascertain what people patronize as a particular is difficult. However, you must make an attempt to discover what makes your competitors unique. Is it the magnetism of the owner, the décor, ambiance, or menu items? You can use your findings to evaluate which of your strengths could be incorporated into your restaurant.

The third step in the external evaluation process in to analyze local community events. It is imperative that you be aware of all major events. Community events include activities such as local church bazaars, festivals, carnivals, and concerts.

Evaluating the economic conditions

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The forth step of the external evaluation process is to analyze economic conditions outside of your restaurant. You must look at the stability of suppliers, utility companies, the local government, and other such entities to determine if any changes in their financial performance will affect your business. Some questions to ask are:

1. How is the company progressing? Are the economic conditions expected to get better or worse? How will the changes affect my restaurant?

2. Will the local utility companies be increasing rates? Rate increases will affect your restaurants profitability.

3. What is the financial stability of my suppliers? Are any of them threatening to go out of business, thus forcing me to purchase from more expensive suppliers?

4. Are any major increases in foods or other costs anticipated that may greatly affect my restaurant's sales?

Analyzing internal financial data

Once all the external factors have been compiled and analyzed, the next step is to analyze your financial data. The data that should be analyzed includes:

1.Profit and loss statements

2. Employee schedules

3. Check average

4. Guest counts

The picture of a restaurant's financial health is usually the profit and loss statement. If, available, you should use at least three statements from previous years for this step. Each line on the statement must be analyzed.

One of the better methods of analysis is called 'Trend Analysis'. 'Trend Analysis' involves taking percentage and dollar changes from year to year.

For example, between years one and two, a restaurant's sales may have increased $700,000 to $800,000. The increase is $100,000 and amounts to a 14.30 percent increase ($100,000 divided by the base of $700,000 times 100). If food cost increased from 35 percent to 38 percent, the cost has increased by 8.60 percent (three percentage points difference, divided by the 35 percent base times 100). Similarly, the trends of all other line items are calculated.

The second source of internal factors that should be evaluated is employee schedules. One typical schedule for each month should suffice. The schedules should include schedule hours, wage rates, and actual hours worked with actual wages paid. The schedules combined with other information, such as anticipated wage increases or additions to staff, to forecast the labor for the year.

The third source of internal information for the evaluation phase analysis is average check size and guest counts. Both of these statistics should be maintained for each meal period on a daily basis.

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A trend analysis follows, reflecting percentage and dollar changes. The trends are then judged as either favorable or unfavorable. The results of the analysis become the basis for projections in the planning phase.

Once the evaluation phase is complete, most of your work is done. The next step is to take all the information and the analysis of the evaluation phase to cast the budget so you will have the following:

1. Anticipated sales and expenses for the year and for each month of the year.

2. The achievable level point.

3. An indication of when during the year cash shortages or cash excesses may occur.

4. A road map that functions as a control upon the financial performances of the operation.

Projecting sales figures…

The first step in the planning phase is the projection of sales. You should use the analysis projection of

sales. You should use the analysis of the external and internal factors in the evaluation process to arrive at projected sales figures. The projections should be made for each typical day of the week during each month of the year. For example, if January of the budget year has five Mondays, the number five is multiplied by the projected guest counts to obtain sales figures for all Mondays in the month of January. The process is repeated for each day of the week and each month. The figures for the 12 months are added to obtain the year's forecast.

Both food and beverage sales may be forecast using the same methods. However, cover counts for beverage sales are often not available. In that case, the beverage sales can be projected by using a historical ratio food sales to beverage sales. The forecast may be adjusted to reflect information that was analyzed in the evaluation phase. Other sales, such as banquet sales, can also be projected using similar techniques.

The second step in the planning phase is the forecasting of the cost of goods sold. The cost of goods sold is the cost of food items and the cost of beverages. Again, the information analyzed in the evaluation phase forms the basis for the future predictions. If the food cost percentage has been increasing, you can forecast an increase at the same percentage. If, however, you plan to reduce portion sizes or use less expensive ingredients, you can forecast a decrease in the cost.

Forecasting the payroll…

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The third step in the planning phase is to forecast the payroll. Based on the new sales projections, staff levels may have to be changed and wages and salaries may have to be adjusted as well. After accounting for these changes, you should forecast payroll cost for a typical week during each month and multiply that week's cost by the number of weeks in the month to obtain a monthly cost. Employee benefits and payroll taxes are added on as a percentage of total sales based on historical analysis and any projected increases.

The forth step in the planning phase is to forecast controllable expenses. Controllable expenses consist of direct operating expenses, music, and entertainment, advertising and promotion, utilities, administrative and general expenses, and repairs and maintenances. A description of each expense can be found in The Uniform System of Accounts for Restaurants available through the National Restaurant Association. As before, base your projections on the previous year's analysis and any other facts discovered during the evaluation phase.

The controllable expenses are not normally projected as a percentage of total sales, except for music and entertainment and advertising and sales promotion expenses, which may be forecast as dollar amounts base on your plans and current practices. For example, if you plan to hire a piano player, be sure to reflect this added expense under music and entertainment.

The fifth step of the planning phase is to forecast non-controllable expenses of occupation costs, such and rent, property taxes, insurance and other taxes including income tax. These items can be projected as an exact dollar amount since they will not vary with sales.

The result of the fifth planning step will be profit before deprecation. Subtract depreciation from this amount to come up with profit before income tax. Lastly, forecast your income taxes based upon your tax liability.

The final step…

The final step is to transfer all sales and expense figures onto a budget worksheet. A budget worksheet should always have columns for both budget, actual figures, and variances to allow for companions during the control phase.

Subtract all expenses from sales to calculate the forecast profit. It the projected profit does not agree with your goals for next years, you must decide what needs to be done to arrive at a more desirable profit.

Changes made in the budget have to be fully considered. For example, if you decrease your advertising and promotion budget, you should consider the decrease in sales that may follow.

The control phase

Once the budget has been cast, it becomes a tool for control. During the control phase, you should compare actual results with budgeted amounts, calculate the variances and act upon any significant unfavorable variances.

Each month, both a dollar variance and a percentage variance should be calculated for each budgeted amount.

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After calculating the variances, you should decide whether the variance is significant and worthy of further investigation, you could set a standard. For example, a 10 percent variance, above which all variances would be investigated or you could set a dollar amount.

If you discover a definite cause of the variance during the investigation, you can plan for methods to correct the problem. For example, if dessert sales have been suffering you can initiate a server incentive plan to increase sales.

A final comment on the control phase: The restaurant business is a dynamic one and is affected by many factors. Any of the external factors could differ from what you initially perceived during the evaluation phase.

For instance, if the expected new office building does not open on schedule, a forecast based on its opening would be inaccurate. As the year progresses, you must adjust the budget to reflect the changes occurring.

Never view the budget as static and unchanging.

I have attempted to detail a simplified approach to restaurant budgeting. All of the steps may not be applicable or necessary for your operation. However, a diligent attempt at the process will produce benefits that include:

1. Discovering where your sales originate and what can be done to develop them.

2. Evaluating the competition

3. Developing more complete and more accurate financial records.

4. Defining sales, expenses and profit goals by which to manage your restaurant.

5. Uncovering variances from the budget so you can act upon them promptly and prudently and,

6. Creating a peace of mind that results from knowing how your restaurant is performing on a monthly basis.

The step-by-step budgeting recipe

Step one

The Evaluation Phase

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1. Evaluate the sales generators.

2. Evaluate the competition.

3. Evaluate community activities.

4. Evaluate other economic factors.

5. Evaluate the restaurant's internal financial data.

Step two

The Planning Phase

1. Plan the sales

2. Plan food cost and beverage cost

3. Plan payroll cost

4. Plan controllable expenses

5. Plan other expenses

6. Plan the profit level

Step three

The Control Phase

1. Control through comparisons of actual results to budgeted amounts

2. Control through evaluating significant variances and determining causes of the variances

3. Control through timely reactions upon significantly unfavorable variances

For more information on the budgeting process call Ron Santibanez at Profit Line Consulting. 866-903-5875