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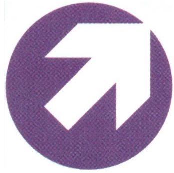
Formula for making MONEY

You can get rich in the restaurant business or you can lose it all



Despite the risks, most operators in Canada make a decent living at it. The Canadian Restaurant and Foodservices Association is reporting $598,000 in average unit sales for all restaurant segments combined in 2010. At the average, a Canadian operator earns approximately $43,500 in cash flow based on the margins reported in the most recent CRFA Foodservice Operations Report.

Cash flow of $43,500 does not sound like much, but it is not as bad as it looks:

- It is the cash generated after paying the salary of the operator
- It is the middle of the pack; many operators do better
- It is after paying franchisors for the value they add, and
- Average sales include many small, limited-service operations where running more than one unit is part of the business model

There is money to be made in the restaurant business – there surely must be or we would not have more than 81,000 restaurants in this country. So what is the formula?

Part one is getting the guest proposition right. Giving the guests what they want, when they want it, at a better price is what brings people in. Go to a busy restaurant, with one beside it that is not busy, to see the power of giving guests what they want. Guests vote with their wallets, and they tend to vote for restaurants that provide value for money that is better than the competition.

Part two of the formula is how you make money. Frankly, if you don't make money you don't have a business. Profits attract investment. Without investment there are no new restaurants.

So how do you measure how well you are doing and whether you have made a good investment? One great way is "cash-on-cash return," which is based on two numbers:

1) Cash invested including leaseholds, equipment, furniture and signage

2) Cash margins you earn on the guests you serve after paying all your costs including your rent

The sidebar shows how that formula works for the average Canadian restaurant. Cash-on-cash return is one of the simpler ways of measuring your profitability.

The 29 per cent average return on cash invested in the sidebar looks like a very big number. Higher returns go with higher risk, and the restaurant business can be very risky. One third of restaurant and accommodation businesses do not make the five-year mark.

A good way to illustrate the risk is to take 20 per cent of the sales volume out of the average restaurant numbers in the sidebar. Losing that many guests would be enough to wipe out all the cash flow. Anyone who has ever worked in a large restaurant chain knows there are many units that perform at or below 20 per cent from the average.

Good returns attract investment. A number of U.S. investment firms have studied the chains that grow and ones that do not. One of the things they consistently find is that chains that earn a 30 per cent cash-on-cash return on long-term restaurant investments are the ones that grow. Chains that earn significantly less are not able to keep their growth strategy alive.

"Your unit economic model is not just the average of the restaurants you operate," says Wayne Holm, founder of Milestones Restaurants. "It is the model for the next one you will open, and it has to be robust."

Are you making an attractive cash-on-cash return? Will you be able to make over 30 per cent cash on cash if you open another?

That is where we come back to giving the guest what they want. Great restaurants, and there are many, build their guest counts with compelling value for money in service, ambiance, price, portion and personality that consistently meets and exceeds expectations. Combine healthy traffic numbers with getting your capital investment right, getting the right rent, keeping your costs in line, and operating consistently and you have a formula that makes for attractive financial returns.

Average returns are earned by average restaurants. Better returns are made by those who are driven to do more and look for every way they can to improve their guest counts, cash margins and investment on the next restaurant they open.

NOTE: Similar cash-on-cash returns for chains are often calculated removing general and administration costs and removing debt and interest costs. Pre-opening costs and working capital are also often not included.

What are the returns in an average Canadian restaurant? With a few simple assumptions it is estimated that the average return is close to 30 per cent cash on cash.

Average sales	$598,000
Average cash flow	43,500
Average cash invested	$149,000
Cash-on-cash return	29%

Sources: CRFA 2010 sales and units, CRFA 2010 Operations Report pretax plus depreciation expense
Capital Assumptions: Sales to investment of 2 to 1. Debt to equity of 1 to 1.

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