Restaurant Case-Study: Summary

This document outlines the story for the start-up and development of a restaurant business, for use in strategy and business planning. The case is structured in two parts – the start-up of a single restaurant unit, and the development of a larger business with many restaurants of the same type.

Note that, although greatly simplified, this case reflects closely the background for a real business.

1. Starting-up a single new restaurant.

You have seen a restaurant unit in your local area that is available for rent. You have always wanted to run a restaurant, so now maybe you can fulfil your dream! The unit is located in a suburban community, rather than in a city, town centre or beside a main highway.

You want to develop the most successful restaurant in the local area, and to be known by middle income adults as the best restaurant in that area for nice meals – not cheap food or take-away, nor expensive 'fine dining'. You believe that more of those people would eat out, and do so more often, if offered the kind of restaurant you plan to open.

You aim to offer reliably good-quality food, with both already popular dishes, and some more unusual items. You find that friendly service in an interestingly designed and well-maintained environment will be especially valued by your target customers. You hope to attract staff who will stay with you for a long time, by sharing with them the long-term profits of the business. Loyal staff, rather than casual labour, should develop friendly relationships with your customers, making them loyal also.

Customers, of course, will drive your sales and revenue. Your study of local population data suggests there are about 10,000 of the people you want in the area, though competition from other restaurants means you will probably capture only a fraction of these. If you could win, say, 4,000 such customers, each of whom visits the restaurant every 4 weeks, you would sell 1,000 meals each week – for which you estimate you will need 80 seats in your restaurant. At a price of $20 per meal, you should take $20,000 per week, or about $1million per year.

You will not be the only restaurant in the area, of course, so you study existing competitors to check that the market target you have chosen is not already well served. You find there are some twenty other operators in the local market - cheap fast food outlets with seating, a few ethnic cuisine restaurants that seem to be busy on weekend evenings, and some rather expensive places. Few seem to be offering exactly the style of restaurant, food or service that you plan.

Your menu needs to offer enough variety to appeal to most of your target customers, but not so wide that food ingredients and wastage will be too costly. Your study of what other restaurants offer suggests that 40 main items should be enough. You plan to offer products that are already popular, so customers will find things they know they will like. You think, though, that some novel products will keep customers coming back, so you plan to include in this range some more unusual items, and to keep introducing new products often enough that the typical customer would normally find a few surprising items.

You can buy some food ingredients – especially fresh meat and vegetables – from local markets, and will source others from wholesale suppliers. These wholesalers also provide the small non-food items, such as cutlery and napkins. Drink products are available from a large drinks wholesaler. Most of these drinks will be well known consumer brands. You will also, of course, have to buy utilities – power, gas and water – pay rent to the owner of the property, and spend money on maintaining the restaurant and repairing any damage.

If the cost food and drink items amounts to 45% of the price you charge to customers, your gross margin (the margin left after deducting 'cost of goods sold' or COGS) will be 55%. So if sales revenue is $1.0million per year, your gross profit on sales will be $0.55 million per year. This must be enough to pay for the estimated nine staff you will need, rent and other fixed costs such as fuel, maintenance of the restaurant and its fittings, and the cost of any marketing you decide to do. You hope this will leave you with an operating profit, before interest and taxes, of around $150,000 per year ($0.15million).

As well as the menu, other resources you will need are staff to prepare and serve the meals, kitchen equipment, and dining furniture. Fitting out the restaurant and buying these items will cost $200,000. This money will be used to pay the designer and builders who will develop the unit for you, and the suppliers of equipment and furniture. You can raise some $50,000 yourself, and will need to borrow another $150,000 from the bank.

You will have to make enough operating profit to pay the interest on the bank loan, and on any overdraft you build up if you make losses on the business. This leaves a profit after interest, on which you will have to pay business tax. Finally, you must make regular payments to the bank to pay off your start-up loan over 4 years.

The following table gives an example of what the income statement might look like, if the restaurant achieves just part of what you believe may be possible. (*The actual revenue costs and profits in any period will vary, depending on your decisions and the restaurant's success in winning customers and sales*):

	$ per meal	$ per week	percent	$'000 per quarter
Sales revenue	**18.00**	**13,500**		**175.5**
Cost of food and drink	8.10	6,075	45.0%	**79.0**
Gross margin	**9.90**	**7,425**	**55.0%**	**96.5**
Staff cost (9 people)	3.00	2,250	16.7%	**29.3**
Repairs and maintenance	0.13	100	0.7%	**1.3**
Marketing	0.13	100	0.7%	**1.3**
Rent	1.60	1,200	8.9%	**15.6**
Depreciation	0.64	480	3.6%	**6.2**
Other fixed costs	0.53	400	3.0%	**5.2**
Total operating costs	**6.04**	**4,530**	**33.6%**	**58.9**
Profit before interest	**3.86**	**2,895**	**21.4%**	**37.6**
Interest on loan	0.77	577	4.3%	**7.5**
Profit after interest	**3.09**	**2,318**	**17.2%**	**30.1**

2. Expanding a larger restaurant chain.

Time has moved on from the start-up of your first restaurant, and you are now running a number of units, based on the same business model as your first. The business now also has a central headquarters that provides support services, such as purchasing and supply, and product development. It also has central functions such as financial accounting. At some point, you will not be able to supervise the increasingly large number of units in the chain, so will need to hire area managers who can look after several units each.

You still want each restaurant to be the most successful in its area, and to be famous for offering the best mid-price meals for a wide variety of customers and occasions. You also believe you can develop a large business, dominating this attractive and growing part of the market in local communities across a large region.

As well as adult couples, you think you could attract families with children, older people, and single-sex groups. As well as serving your already popular evening meals, you hope to win customers for leisurely weekend lunches, shorter lunch breaks during the week, and some special occasions such as birthdays and anniversaries. Some people may even come simply because they cannot be bothered to cook!

Each of your restaurants is in a different locality, with its own potential customers. From analysis of population data, and a study of other restaurants in the region where you operate, you estimate there could be 100 such locations where you could open units over the following few years. Economic growth and an expanding population could make it possible to add still more units. However, the economy has been growing strongly for some time, and there are fears that growth could stall or possibly that the economy could decline. Eating out is not an essential item for consumers to spend on, like housing or fuel, so could be hit hard by such a recession.

From surveying the needs of existing customers and others, you estimate that you could capture enough additional customers and meal occasions for each unit to achieve 50% more sales than currently. This would give you about $150million in revenue by the end of the expansion plan. You will have to be careful, though. If you open too many restaurants, each new location will reach fewer additional customers, and may even start to take customers from existing units!

Recently a new competitor seems to have noticed your success, and opened similar restaurants within easy travel distance of some of your existing units. So far, these units are doing well, and your nearby units have seen a fall of about 30% in sales, which suggests that the competitor is winning a significant amount of new business, as well as stealing your customers. Their pricing, which is rather less than yours, may be a significant reason for their success, though you wonder how they are going to be sufficiently profitable to survive and grow.

You expect your restaurant operations to continue much as before, but are looking for ways to improve profit margins. Widening the menu will attract more types of customer, and for different meal occasions. However, it may slightly increase your average cost of food ingredients, due to buying lower quantities of each item and increased wastage. However, food preparation technology means you will be able to provide this wider range with more reliable quality, and also serve customers more quickly.

It has been quite challenging to find and open your first few restaurants, not just because of competition from others wanting good quality retail locations, but also because of restrictions and permit requirements regarding the type of premises in which restaurants can operate. However, these restrictions and permits are being relaxed, which should make more potential properties available, shorten the time to get them opened, and reduce the development cost.

The busier restaurants should be more profitable on average, because more sales revenue will be covering the same fixed costs, so even after central costs, you should still make operating profits of $20million per year on sales of $150 million from 100 units.