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Funding True Restaurants

By Dennis Monroe

There are three types of financing in the restaurant industry. The first source of financing is the public sector, and it gets all the press and discussions that typically surround an initial public offering or merger and acquisition.

The second is what I would call macro financing, which encompasses large transactions, capital markets and lenders that provide significant capital, normally for the franchise restaurant space.

The third is what I like to call micro financing, which is site-specific, focusing on individual, often chef-driven restaurants. In many cases, micro financing is the lifeblood of the industry, because the restaurants it funds are incubated concepts that later become the concepts for multi-unit companies and franchisors. It is this third type of financing and all of its elements that this article will address.

The Concept

When I meet with a restaurateur who has a new concept, I try to have the owner focus on the following questions::

1. Why is your concept unique?

2. What is your potential customer base?

3. Who are the immediate competitors of your concept?

4. What type of following do you as a restaurateur have in your community?

Financial Feasibility

We next need to evaluate the concept's financial viability, using certain financial matrices and asking the following questions:

1. What is the cost of starting the restaurant? (This cost includes all buildout, lease costs and working capital.)

2. What is the realistic sales level for your concept and what level will the sales grow?

3. Can you achieve a 15%-plus operating profit at the store level?

4. Will the cash flow of the restaurant, after capital improvements, provide a return of 20% (cash on cash) for any equity investment?

Capital Structure

Once the above questions have been answered, the restaurateur needs to figure out funding (which is the biggest challenge for restaurateurs). When I meet with a restaurateur, I typically walk through the types of structure most investors want for an investment in a single restaurant. This type of investment is either a high-priced loan or a preferred equity interest. In most cases, the investor gets their money back first with some kind of stated return and then has a carry interest going forward.

Finding Investors

The real difficulty is finding potential investors. Here are some things to think about.

1. Do you have wealthy relatives who would invest in your restaurant? Have you developed a customer following for your food at the restaurants you have worked at or managed? (Often the primary funding sources for the restaurateur's first major restaurant are people the owner knows.)

2. Are there other restaurants in town that might be willing to help you incubate your concept for an ongoing piece of the concept, with the ability to acquire the restaurant in the future?

3. Are there government programs or vendor suppliers that may want to fund some working capital?

4. What can the landlord do to help fund this new concept?

5. Have you looked at bank lending, specifically the SBA or equipment leasing sources?

6. Have you talked to your attorneys and accountants, who can either help in sourcing potential investors or who may even agree to invest themselves?

Taking all of the above into account, the restaurateur should put together a concept and financing package. In most cases, the restaurateur needs help with developing a plan of who to go to first and what the steps are. They need to be introduced to design firms, architects and site finders. (It is always easier to raise money and find willing investors if there is a defined site and concept plan which is drawn out and can be visualized.).

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I always tell restaurateurs to find a site first, have a designer or architect put together the rendering of their concept, and then calculate the amount of money needed for the restaurant investment. After these items are in place, the really hard work begins.

I firmly believe young restaurateurs are the only ones who can sell their restaurants. We lawyers and accountants are the ones to make sure restaurateurs follow the rules and to keep them from giving away the house on the first deal.

The steep financial learning curve notwithstanding, it is still an extremely vital market for new concepts and restaurateurs. There are always potential investors who care about good food and love being able to have an interest in an up-and-coming restaurant, particularly one that gets a lot of notoriety. It has always been my pleasure to work with emerging concepts and see the restaurant exceed and grow.

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