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In rush to fully reopen, consider unit economics

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WE ARE ALL ANXIOUS TO GET our restaurants reopened. And therefore, we are all anxious to come up with new ideas to attract back our customers and attract new ones. But keep in mind one thing that has held true in the restaurant industry for 100 years: Each restaurant unit needs to be economically sound and follow the fundamentals of restaurant profitability.

Here are a few ideas to keep in mind as you either continue with your open restaurant and hopefully expand it or are just planning to reopen with your existing or modified concept.

Revenue does not solve all problems. There is a certain level of revenue that all restaurants need to operate successfully at. This is dictated by the lease and the overall occupancy cost, which is dependent on the location and size of the restaurant, so make sure your concept can do enough revenue to justify your rent. Even if you own the building, ensure your concept can justify your return on the real estate ownership. If it doesn't, maybe it's the wrong concept or the occupancy cost is above market and needs to be adjusted—even if it was adjusted during COVID. We are looking at the long-term now.

Labor cost. We all have either read or know from personal experience, the issues around securing adequate labor. The key to a successful restaurant is the people, so treat your people well. It's important to keep labor costs in line. I like to use 30 percent as a maximum, all-in labor cost. That doesn't mean salaries and hourly wages can't be at or above the market, but rather that you've built a labor model that fits the concept and the overall revenue.

So think of making sure you are cross-training; that you're providing good benefits, including health insurance and other items that are going to attract the very best people. The very best people are cheaper than a number of not-so-committed people. Also, make sure employees feel like they are not just employees, but partners. Provide appropriate incentive plans, phantom ownership and keep the labor model flat. That means have as many people doing as many different things as possible. That is what hospitality is about. If you've got good people that are hospitality oriented, they are more than willing to do a number of different tasks to make the restaurant work. Owners need to be in the restaurants and they need to be on the front line.

Prime cost. We always talk about food cost and food cost is key, but normally food cost drives what the menu pricing is and therefore you can normally control it. Deal with waste, be practical with the items you are offering, but restaurants are all about the food and the customers. Look at all the prime costs and make sure every item is priced out on the menu and that you are using the latest technology.

Additionally, things like packaging and supplies are taking up a bigger chunk of the revenue dollars,

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particularly as it relates to takeout and delivery, which has become a necessary revenue source. One of the things that I have tried to emphasize is to know your delivery and takeout costs and to understand them, from the indirect labor cost to the opportunities gained and lost by these food on demand ways of delivering your restaurant concept. So spend time analyzing this and don't kid yourself and think that you can whip through these kinds of analyses quickly. Be critical and use other resources like your fellow restaurant owners and accountants and lawyers that specialize in this space.

Evolving your concept. Taking into account the above, some have considered evolving from casual to fast casual, or from fast casual to quick service. This evolution can certainly deal with labor cost and options for more revenue sources.

Return on investment. No matter how much you try to drive revenue and control costs, it still gets down to return on investment, because ROI will drive whether the restaurant stays open. If there is no return and it is break even, it doesn't take long to hit another glitch and have a problem. I have always used a threshold of 20 percent. This means your actual capital into the restaurant, including annual capital investments. Make sure that the collective return is money that can be distributed out to the owners—whether it is elected to be distributed out or not, is a different story—is equal to 20 percent or more. One of the key matrix we like to see is store operating profit. That means before outside general administrative expenses or things not necessarily related to the unit, but allocated to it, should be a minimum of 15 percent and preferably closer to 20 percent (and hopefully more than 20 percent). Secondly, I like to see sales equal to three times your investment, so that means even if you make a capital improvement, your sales should go up three times that capital improvement. Just some guidelines, not necessarily exact numbers, but targets to shoot for.

Finally, if the restaurant has good unit economics and has some real what we'll call "legs," and can be opened in other spots and be successful, then expansion is something to consider. Good concepts are replicable unless they have a unique location and the concept is specific to that location. So always look at expandability, which is where investors can be involved. Investors like to see units that work and they like to be involved in growth, so don't forget the unit economics can drive growth. FSN

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