

# THE CASE FOR THEORETICAL COSTS

By Mark Kelnhofer, MBA

More than likely, restaurant operators are familiar with the benefits of utilizing theoretical costs for benchmarking their store locations' performance. However, most of the restaurant operators do not utilize this concept and base a store's performance strictly off of costs as a percent of sales. Although it is important to obtain and review cost as a percent, it should not be the only factor in determining the productivity of the restaurant.

There are two primary factors that would make a cost percent benchmark invalid. The first is the menu mix. As an example, store A ran a higher mix of steak menu items that drove their cost to 31.0%. Store B had a higher level of pasta dishes sold which resulted in a cost of 28.0%. Does that mean store A is performing worse than store B? The answer is absolutely not. Store A could have executed the stated recipes at a high level and still would have posted a high cost percent. The other factor is that costs for purchased products are not all the same for every restaurant market. The location of the restaurant will greatly affect the pricing of products. As an example, a store in the Boston area should be able to get better pricing on fresh seafood than a store in Columbus, Ohio.

In order to obtain a theoretical cost for the location sales volume quantities and cost per plate are needed. The accuracy of the recipe cost is paramount to ensuring the theoretical is accurate (see our article "Obtaining Accurate Recipe Costs"). In order to gain a theoretical cost extend the cost per plate by the quantity sold. The total of all of the line item extensions is the cost in dollars.

Once the total actual cost and theoretical cost dollars are calculated, a simple calculation can be executed to determine the efficiency of the restaurant

location. By taking the actual cost dollars and dividing them into the sales dollars, the actual cost percent can be determined. The next step is to take the total theoretical cost dollars and divide them into the same sales dollars to obtain the theoretical cost percentage. Once both percentages have been calculated, it is possible to determine how efficient the restaurant is running. Keep in mind, the operations cannot hit the "perfect world" theoretical. However, we can gauge how far away they are. As long as all the locations theoretical costs are based on the same recipes, there is a very comparable benchmark.

Now let's take our previous example one step further. Store A has an actual cost of 31.0% and we have calculated their theoretical cost being 28.5%. This means they are 2.5% away from their theoretical cost. Store B has an actual cost of 28.0% and we calculated their theoretical cost being 24.5% (due to their shift of pasta mix). Store B is 3.5% away from their theoretical cost, a full percentage point greater than Store A.

Without the use of theoretical costs as a benchmark of performance evaluation, it is very easy to place your focus on the incorrect locations

(i.e. high actual cost in Store A's case). Actual costs are important, but they should not be the only number in which to base performance. In addition, it gives the management the opportunity to assist Store B in becoming more efficient (i.e. closer to the theoretical food cost). The goal should be to have all the locations as efficient as possible, closing the gap between actual cost and theoretical costs. The bottom line will improve within the process.

*Mark Kelnhofer is the President and CEO of Return On Ingredients LLC and has over 15 years in management accounting experience including seven years in fine dining restaurant industry. He can be reached at (614) 558-2239 and Mark@ReturnOnIngredients.com.*

*"If you do not benchmark actual versus theoretical costs, you may be not fairly reviewing the stores' performance."*