Chapter 1

Managing Revenue and Expense

Learning Outcomes

At the conclusion of this chapter, you will be able to:

• Apply the formula used to determine business profits.

It is important that managers be able to calculate the amount of profit earned in their businesses. The ability to operate a profitable business is one of the major factors that determine managers' pay rates as well as the likelihood that they will be promoted to levels of higher responsibility in the organizations that employ them.

For those who own their own businesses, it is imperative that they know the amount of profits their businesses generate.

• Express business expenses and profits as a percentage of revenue.

While the expenses incurred and profits generated in a business can be expressed in a variety of ways, one of the most common ways to do so is as a percentage of revenue. As result, the ability to accurately calculate expense and profit percentages is a key skill that all good managers must acquire.

• Compare actual operating results with budgeted operating results.

As you will learn in this chapter, a budget is a forecast of future operating performance. Managers compare their actual operating results with their budgeted operating results to identify areas where improvements in their businesses can be made. The ability to constantly improve their organizations is a key skill possessed by the very best managers in the hospitality industry.
Study Notes

1. Professional Foodservice Manager

- A professional foodservice manager is unique because all the functions of product sales, from item conceptualization to product delivery are in the hands of the same individual.

- Because foodservice operators are in the service sector of business, many aspects of management are more difficult for them than for their manufacturing or retailing management counterparts.

- A foodservice manager is one of the few types of managers who actually have contact with the ultimate consumer. The foodservice operator must serve as a food factory supervisor, as well as a cost control manager.

- Excellence in operation is measured in terms of producing and delivering quality products in a way that assures an appropriate operating profit for the owners.

2. Profit: The Reward for Service

- If management focuses on controlling costs more than on servicing guests, problems will certainly surface.

- Management’s primary responsibility is to deliver a quality products and services to the guest, at a price mutually agreeable to both parties. You do not want to get yourself in the mind-set of reducing costs to the point where it is thought that "low" costs are good, and "high" costs are bad.

- When management attempts to reduce costs with no regard for the impact on the balance between managing costs and guest satisfaction, the business will surely suffer. Efforts to reduce costs that result in unsafe conditions for guests or employees are never wise.

- The question is whether costs are too high or too low, given management’s view of the value it hopes to deliver to the guest and the goals of the foodservice operation’s owners.

- The difference between what you have paid for the goods you sell and the price at which you sell them does not represent your actual profit.

- Revenue is the amount of dollars you take in.

- Expenses are the costs of the items required to operate the business.
- **Profit** is the amount of dollars that remain after all expenses have been paid.

\[
\text{Revenue} - \text{Expenses} = \text{Profit}
\]

- For the purposes of this book, the authors will use the following terms interchangeably: revenue and sales; expenses and costs.

- All foodservice operations, including nonprofit institutions, need revenue in excess of expenses if they are to thrive.

- Profit is the result of solid planning, sound management, and careful decision-making.

\[
\text{Revenue} - \text{Desired Profit} = \text{Ideal Expense}
\]

- **Ideal Expense** is defined as management's view of the correct or appropriate amount of expense necessary to generate a given quantity of revenue.

- **Desired profit** is defined as the profit that the owner wants to achieve on that predicted quantity of revenue. Profit is the reward for providing service.

- Revenue varies with both the number of guests frequenting your business and the amount of money spent by each guest.

- You can increase revenue by increasing the number of guests you serve, by increasing the amount each guest spends, or by a combination of both approaches.

- **Sustainable development** is a term used to describe a variety of earth-friendly practices and policies designed to meet the needs of the present population without compromising the ability of future generations to meet their own needs.

- The positive benefits that accrue when businesses incorporate green activities are significant and they are increasing.

- There are four major foodservice expense categories that you must learn to control.
  a. **Food costs** are the costs associated with actually producing the menu items. In most cases, food costs will make up the largest or second largest expense category you must learn to manage.
  b. **Beverage costs** are those related to the sale of alcoholic beverages. Costs of a nonalcoholic nature are considered an expense in the food cost category. Alcoholic beverages accounted for in the beverage cost category include beer, wine, and liquor. It may also include the costs
of ingredients necessary to produce these drinks, such as cherries, lemons, olives, limes, mixers like carbonated beverages and juices, and other items commonly used in the production and service of alcoholic beverages.

c. **Labor costs** include the cost of all employees necessary to run the business, including taxes. In most operations, labor costs are second only to food costs in total dollars spent. Some operators find it helpful to include the cost of management in this category. Others prefer to place the cost of managers in the Other Expense category.

d. **Other expenses** include all expenses that are neither food nor beverage nor labor.

3. **Getting Started**

- Good managers learn to understand, control, and manage their expenses. Numbers can be difficult to interpret due to inflation. Therefore, the industry uses percentage calculations.

- Percentages are the most common standard used for evaluating costs in the foodservice industry. As a manager in the foodservice industry you will be evaluated primarily on your ability to compute, analyze, and control these percent figures.

- **Percent (%)** means “out of each hundred.”

- There are three (3) ways to write a percentage:

  **Common Form**
  In its common form, the "%" sign is used to express the percentage, as in 10%.

  **Fraction Form**
  In fraction form, the percent is expressed as the part, or a portion of 100, as in 10/100.

  **Decimal Form**
  The decimal form uses the decimal point (.) to express the percentage relationship, as in 0.10.

- To determine what percent one number is of another number, divide the number that is the part by the number that is the whole.

  \[
  \frac{\text{Part}}{\text{Whole}} = \text{Percent}
  \]
• If we want to know what percentage of our revenue went to pay for our expenses, we would compute it as follows:

\[
\frac{\text{Expense}}{\text{Revenue}} = \text{Expense \%}
\]

• As long as expense is smaller than revenue, some profit will be generated. You can computer profit % using the following formula:

\[
\frac{\text{Profit}}{\text{Revenue}} = \text{Profit \%}
\]

• Modified profit formula:

\[
\text{Revenue} - (\text{Food and beverage costs} + \text{Labor costs} + \text{Other expenses}) = \text{Profit}
\]

• Put in another format, the equation looks as follows:

\[
\begin{align*}
\text{Revenue (100\%)} & \\
- \text{Food and beverage cost \%} & \\
- \text{Labor cost \%} & \\
- \text{Other expenses \%} & \\
= & \text{Profit \%}
\end{align*}
\]

4. Understanding the Income (Profit and Loss) Statement

• An accounting tool that details revenue, expenses and profit, for a given period of time, is called the **income statement**, commonly referred to as a **profit and loss statement (P&L)**. It lists revenue, food and beverage costs, labor costs, other expenses, and profit.

• The P&L is important because it indicates the efficiency and profitability of an operation.

• The primary purpose of preparing a P&L is to identify revenue, expenses, and profits for a specific time period.
• Common percentages used in a P&L statement:

1. \[
\frac{\text{Food and beverage costs}}{\text{Revenue}} = \text{Food and beverage cost %}
\]

2. \[
\frac{\text{Labor costs}}{\text{Revenue}} = \text{Labor cost %}
\]

3. \[
\frac{\text{Other expenses}}{\text{Revenue}} = \text{Other expenses %}
\]

4. \[
\frac{\text{Total expenses}}{\text{Revenue}} = \text{Total expenses %}
\]

5. \[
\frac{\text{Profit}}{\text{Revenue}} = \text{Profit %}
\]

• The Uniform System of Accounts for Restaurants (USAR) is used to report financial results in most foodservice units. This system was created to ensure uniform reporting of financial results.

5. **Understanding the Budget**

• A **budget** is simply an estimate of projected revenue, expense, and profit.

• The budget is known as the **plan**, referring to the fact that the budget details the operation’s estimated, or planned for, revenue and expense for a given period of time.

• All effective managers, whether in the commercial (for-profit) or nonprofit sector, use budgets.

• **Performance to budget** is the percentage of the budget actually used.

• The **28-day-period approach** to budgeting divides a year into 13 equal periods of 28 days each. This helps the manager compare performance from one period to the next without having to compensate for “extra” days in any one period.

• Percentages are used to compare actual expenses with the budgeted amount, using this formula:

\[
\frac{\text{Actual}}{\text{Budget}} = \% \text{ of Budget}
\]
• If our budget is accurate, and we are within reasonable limits of our budget, we are said to be “in line” or “in compliance” with our budget. Use the concept of “significant” variation to determine whether a cost control problem exists.

• A significant variation is any variation in expected costs that management feels is an area of concern.

• If significant variations with planned results occur, management must:
  1. Identify the problem.
  2. Determine the cause.
  3. Take corrective action.

6. Technology Tools

• Most hospitality managers would agree that an accurate and timely income statement (P&L statement) is an invaluable aid to their management efforts. There are a variety of software programs on the market that can be used to develop this statement for you.

• Variations include programs that compare your actual results to budgeted figures or forecasts, to prior-month performance, or to prior-year performance. In addition, P&Ls can be produced for any time period, including months, quarters, or years. Most income statement programs will have a budgeting feature and the ability to maintain historical sales and cost records.

• As you examine (in this chapter and others) the cost control technology tools available to you, keep in mind that not all information should be accessible to all parties, and that security of your cost and customer information can be just as critical as accuracy.
Key Terms & Concepts Review
Match the key terms with their correct definitions.

1. Revenue   _____ a. A period of time—that is, hour, day, week, or month—in which an operator wishes to analyze revenue and expenses.

2. Expenses   _____ b. A detailed listing of revenue and expenses for a given accounting period. Also referred to as a profit and loss (P&L) statement.

3. Profit    _____ c. The dollar costs associated with actually producing the menu item(s) a guest selects.

4. Business dining   _____ d. The term used to indicate the dollars taken in by the business in a defined period of time (often referred to as sales).

5. Ideal expense   _____ e. Food is provided as a service to the company’s employees either as a no-cost (to the employee) benefit or at a greatly reduced price.

6. Desired profit   _____ f. The expenses of an operation that are neither food, nor beverage, nor labor.

7. Sustainable development   _____ g. Accounting method that divides a year into 13 equal periods of 28 days each.

8. Food costs   _____ h. The price paid to obtain the items required to operate the business (often referred to as costs).

9. Beverage costs   _____ i. The number "out of each hundred." Thus, 10 percent means 10 out of each 100. This is computed by dividing the part by the whole.

10. Labor costs   _____ j. The profit that an owner seeks to achieve on a predicted quantity of revenue.

11. Other expenses   _____ k. The percent of the budget actually spent on expenses.

12. Percent   _____ l. The dollars that remain after all expenses have been paid (often referred to as net income).

13. Statement of income and expense (income statement)   _____ m. A forecast or estimate of projected revenue, expense, and profit for a defined accounting period.
14. Profit and loss statement (P&L) n. Management's view of the correct or appropriate amount of expense necessary to generate a given quantity of sales.

15. The Uniform System of Accounts o. The costs related to the sale of alcoholic beverages.

16. Budget/plan p. A detailed listing of revenue and expenses for a given accounting period. Also referred to as an income statement.

17. Accounting period q. All expenses (costs), including payroll, required to maintain a workforce in a foodservice operation.

18. Performance to budget r. Standardized sets of procedures used for categorizing revenue and expense in a defined industry, for example, *The Uniform System of Accounts for Restaurants (USAR)*.

19. 28-day-period (approach) s. Earth-friendly practices and policies that meet the needs of the present population without compromising the ability of future generations to meet their own needs.
Discussion Questions

1. List and determine (by indicating yes or no) the different tasks for which foodservice, manufacturing, and retailing managers are responsible.

<table>
<thead>
<tr>
<th>Task</th>
<th>Foodservice Manager</th>
<th>Manufacturing Manager</th>
<th>Retail Manager</th>
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2. List and explain the three different forms of writing a percent.

________________________________________________________________________
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3. List and describe the four major foodservice expense categories.

________________________________________________________________________
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________________________________________________________________________

4. List the three things a foodservice manager should do when there is a significant variation between an operation’s budget and its actual performance.

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

5. List two positive benefits that accrue when businesses incorporate green activities.

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
Quiz Yourself

Choose the letter of the best answer to the questions listed below.

1. When considering costs, foodservice managers must remember that low costs are good and high costs are not as good.
   a. True
   b. False

2. Revenue in the foodservice industry refers to the amount of money taken in by a business.
   a. True
   b. False

3. A cost, in the foodservice industry, is another term used to identify an expense.
   a. True
   b. False

4. Noncommercial foodservice institutions should only be interested in generating enough revenue to equal their operating costs.
   a. True
   b. False

5. Ideal expense is the correct amount of cost required to generate a specific amount of revenue.
   a. True
   b. False

Questions 6 through 9 are based on the following information:

A simplified partial annual P & L statement for The Limpopo River House is shown below:

<table>
<thead>
<tr>
<th>Description</th>
<th>Dollars</th>
<th>Percentages</th>
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</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$1,200,000</td>
<td></td>
</tr>
<tr>
<td>Food &amp; Beverage Costs</td>
<td>375,000</td>
<td></td>
</tr>
<tr>
<td>Labor Costs</td>
<td>425,000</td>
<td></td>
</tr>
<tr>
<td>Other Costs</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. What was the profit percentage for The Limpopo River House?
   a. 16.25%
   b. 25.00%
   c. 37.50%
   d. 63.50%
7. If the desired profit at this level of annual revenues was 18.0%, what was the operation’s ideal amount of expense?
   a. $100,250
   b. $216,000
   c. $568,150
   d. $984,000

8. If the budget for food was $250,000 and the budget for beverages was $70,000, how much over budget was the operation in the food and beverage category?
   a. $45,000
   b. $50,000
   c. $55,000
   d. $60,000

9. What was the operation’s labor cost percentage?
   a. 28.2%
   b. 30.4%
   c. 32.2%
   d. 35.4%

10. If total expenses in an operation were $425,000, and revenue was $465,000, what was the operation’s total expense %?
    a. 91.4%
    b. 101.2%
    c. 111.4%
    d. 121.2%

11. Matt Dain is a foodservice manager. Last month his food expense equaled $60,000, his labor expense equaled $50,000, and his other expenses equaled $19,000. His revenue equaled $160,000. What was his total expense percentage?
    a. 80.6%
    b. 95.2%
    c. 115.6%
    d. 125.2%

12. What is the formula that managers use to calculate profit percentage?
    a. Revenues – Expenses = Profit %
    b. Expenses ÷ Profit = Profit %
    c. Revenue ÷ Sales = Profit %
    d. Profit ÷ Revenues = Profit %
13. What is the formula that managers use to calculate their food and beverage (F&B) cost percentages?
   a. Food and beverage expense ÷ Revenue = F&B cost %
   b. Food and beverage expense ÷ Total expenses = F&B cost %
   c. Total revenue – Food and beverage expense = F&B cost %
   d. Total expenses – Food and beverage expense = F&B cost %

14. What is the labor cost percent formula?
   a. Revenue % – Profit % = Labor cost %
   b. Labor expense ÷ Revenue = Labor cost %
   c. Revenue ÷ Labor expense = Labor cost %
   d. Number of employees – Revenue = Labor cost %

15. What is the formula that managers use to calculate other expenses percent?
   a. Other expenses ÷ Revenue = Other expenses %
   b. Other expenses ÷ Total expenses = Other expenses %
   c. Total revenue – Other expense = Other expenses %
   d. Total expenses – Other expenses = Other expenses %

16. Jackie Wong is a foodservice manager. Last month, his food expense equaled $95,000, his labor expense equaled $53,000, and his other expenses equaled $17,000. His revenue equaled $200,000. What is his profit percentage?
   a. 0.175%
   b. 1.75%
   c. 17.5%
   d. 175.0%

17. Ginger Lee is a foodservice manager. Last month her food expense equaled $70,000, her labor expense equaled $50,000, and her other expenses equaled $8,000. Her revenue equaled $160,000. What was her other expenses percentage?
   a. 0.5%
   b. 2.0%
   c. 5.0%
   d. 20.5%

18. What formula do managers use to calculate percent of budget?
   a. Revenue ÷ Budget = % of Budget
   b. Revenue ÷ Actual = % of Budget
   c. Actual ÷ Budget = % of Budget
   d. Budget ÷ Actual = % of Budget
19. Peggy Richards creates an annual budget for her food facility. Her annual utility costs budget is $75,000. What is the most Peggy can spend on utilities each month and still stay within her annual budget?
   a. $6.25
   b. $62.50
   c. $625.00
   d. $6,250.00

20. What will be the effect on an operation if its manager is able to increase the number of products each guest buys when visiting the operation?
   a. Revenue will go up and costs will go up.
   b. Revenue will go down and costs will go up.
   c. Revenue will go up and costs will go down.
   d. Revenue will go down and costs will go down.

21. Some managers use a budgeting approach that defines 13 equal operating periods, each of which consists of
   a. 27 days.
   b. 28 days.
   c. 29 days.
   d. 30 days.

22. If significant variations exist when comparing actual financial results to planned results, the first thing managers must do is
   a. modify the budget.
   b. determine the cause.
   c. identify the problem.
   d. take corrective action.
Chapter Answers to Key Terms & Concepts Review, Discussion Questions, and Quiz Yourself

Key Terms & Concepts Review

1. d  5. n  9. o  13. b  17. a
2. h  6. j  10. q  14. p  18. k
3. l  7. s  11. f  15. r  19. g
4. e  8. c  12. i  16. m

Discussion Questions

1. List and determine (by indicating yes or no) the different tasks for which foodservice, manufacturing, and retailing managers are responsible.

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</thead>
<tbody>
<tr>
<td>1. Secure raw materials</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>2. Manufacture product</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>3. Distribute to end user</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>4. Market to end user</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>5. Reconcile problems</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>
with end user

2. List and explain the three different forms of writing a percent.

- **Common Form:** In its common form, the "%" sign is used to express the percentage, as in 10%.
- **Fraction Form:** In fraction form, the percent is expressed as the part, or a portion of 100, as in 10/100.
- **Decimal Form:** The decimal form uses the decimal point (.) to express the percent relationship, as in 0.10.

3. List and describe the four major foodservice expense categories.

- **Food costs** include the expense of meats, dairy, fruits, vegetables, and other categories of food items produced by the foodservice operation.
- **Beverage costs** include alcoholic beverages of beer, wine, and liquor.
- **Labor costs** include the cost of all employees necessary to run the business, including taxes.
- **Other expenses** include all expenses that are neither food, nor beverage, nor labor. Examples include franchise fees, utilities, rent, linen, china, glassware, kitchen knives, and pots and pans.
4. List the three things a foodservice manager should do when there is a significant variation between an operation’s budget and its actual performance.
   - Identify the problem.
   - Determine the cause.
   - Take corrective action.

5. List two positive benefits that accrue when businesses incorporate green activities.
   - Managers of green operations help protect the environment.
   - Increasing numbers of customers are committed to preserving the environment, and they most often seek to frequent and support businesses that are committed to this same goal.

**Quiz Yourself**

1. b  6. b  11. a  16. c  21. b  
2. a  7. d  12. d  17. c  22. c  
3. a  8. c  13. a  18. c  
5. a  10. a  15. a  20. a