Case study application – Sustainable Restaurants - B2 Inc.

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Case study information - B^2 Inc.

[All names are fictitious and any resemblance to real people or companies is purely accidental].

1 Introduction

Following a successful career as a city trader Buck Rogers and his partner Bethan, who was a successful executive recruitment consultant and head hunter, decided they wanted to do something different. After serious discussions with their family (two children - a boy and a girl aged 9 & 10 respectively, and a dog), they left New York City in 1981 and started an organic farm in California. The first thing they did was to hire Russ Trafford as the farm manager. Russ had been in farming all his life and brought a wealth of experience and expertise about the industry, and was also passionate about organic farming methods. His knowledge of farming complemented the financial and people management skills of Buck and Bethan. Organic farming was in its infancy when they started and costs were much higher than the intensive farming methods that had become common place in the USA in the 1980's. After five years of hard work they had established a customer list, which included providing fresh organic farm produce to some of the finest restaurants in the area, and their reputation was spreading fast. Their passion for good food and wine led them to purchase a small vineyard, which under the guidance of Kerry Mills, who was hired as a consultant due to her knowledge of the industry, now produces some excellent award winning wines. They were now becoming more and more involved in the developing trends in farming that they embraced the concept of sustainable farming, not all of which involved organic farming methods, but has a strong focus on the farming techniques that have high yields of high quality crops that work with, and lives alongside, the natural environment.

Techniques such as encouraging natural weed and pest controls, prevention of land erosion, maintenance of high soil quality, and provision of land cover necessary to sustain wildlife. The passion for good food and wine did not stop there, and in 1990 Buck and Bethan opened their first restaurant in Sacramento called 'Sustainable'. The restaurant was a huge success and under the guidance of Alejandra Hermaneth, a successful restaurant entrepreneur, they now have 41 restaurants in 41 states in the USA. A company called Sustainable Restaurants was established to manage the restaurant business and is part of B^2 Inc. (a name derived from Buck and Bethan and pronounced B squared), which is the holding company, at that time comprising the restaurant business, the farm and the vineyard.

2. Expansion

As the movement for sustainability gained strength Buck and Bethan immersed themselves in developing B^2 Inc. into a truly diversified company with interests in:

- Farming, which now includes arable, dairy and animal (mainly beef) farms
- Vineyards and wine production
- Restaurants
- Fish farms
- Renewable energy, e.g. wind farms and hydro generation
- Forestry and land management schemes
- Waste management

B^2 Inc. has based its business philosophy on developing the portfolio with a focus on environmental businesses, with maybe the exception of the restaurants, but recognise that sustainability is about much more than environmental issues. They firmly believe in the planet, people, and profit philosophy, and view profit making as an opportunity to invest more in the environmental and sustainable aspects of the business. The group website states unashamedly that their objective is to makes profits to enable them to invest in more sustainable and environmental friendly projects. Note that B^2 Inc. is not listed on the stock exchange and is still a private company, but over the years funds have been raised from private investors, who have the same aims and beliefs as Buck and Bethan. The current shareholdings are as follows.

Buck and Bethan Rogers	55%
Sustainable Venture Capital Limited	20%
Employee share scheme	10%
Other directors	10%
Friends and family	5%

3. The restaurant business

The restaurant business is intensely competitive with many alternatives. It is not just other restaurants that you are competing against for the customer but alternatives such as home cooking, take-away and convenience foods. In good times alternative forms of spending a night out with friends and family become the competition. The restaurant business in the US is worth in the region of $710bn per annum and now that the economy is picking up is expected to grow by about 4% p.a. or 2% in real terms (inflation adjusted). There are over 1m restaurant locations in the US employing about 14m people. The industry attracts many new entrants to the market, but the restaurant business is an industry where the failure rate can be very high. People believe that because they like cooking for friends, and their friends are always very complementary about their cooking, they can start a restaurant, forgetting it is a business, not a hobby. Managing costs such as portion control, and wastage rates are crucial to running a profitable restaurant, and making a return on the initial investment. Awareness marketing is required to get the restaurant noticed, but word of mouth can be just as important in obtaining new business. Customer satisfaction and customer retention is also important, so adding new dishes to the menu on a regular basis, and menu variety, is important. Many restaurants are based on the reputation of the Chef, so getting the right staff can also be a factor of success, as much as quality of service. The rise of the celebrity Chef (who may or not be available to prepare food) is still very much a trend in the industry, as is achieving the Michelin Stars in the Michelin restaurant guide, a guide based on the quality of restaurant experience, including value for money.

Restaurants can be classified in several ways. Full service restaurants offer a full menu and seating facilities; quick service restaurants offer a more limited menu with limited seating and take away options; cafeterias and buffets offer a more casual approach to dining often with an element of self-service. Snack bars can also be classed as competitors depending on the style of menu offered, for example, snack bars can be a competitor for the lunch menu. There are also fine dining restaurants, causal/branded dining – more usually offered by restaurant chains, and restaurants can also be classified by type of cuisine, for example, Thai, Mexican, Chinese, Indian, English, and many more. Restaurant chains are a significant part of the industry where a common theme or brand and common menu items are present in all their restaurants. Local flavour, however, is also significant, so a good restaurant chain will exchange information amongst its restaurants, for example, what did, or did not work well. A significant element of managing a chain is the 'comps' – comparison between restaurants, which can put pressure on restaurant managers to perform, but if well used can also encourage a learning approach between restaurants.

The industry is sensitive to the economy as consumers often trade down when times are hard, for example, move to less expensive options, or reduce the number of times they eat out. Demographics of the catchment area impacts on the style of restaurant that will do well in certain areas, as does the personal income of the people in the target customer group. For example, is the target customer mainly business people or families? The catchment area and location will impact on the number of customers in target groups, so location and target customer groups must match. A high proportion of restaurant failures are due to the menu options or pricing not matching the target customer. For example, a city restaurant may well need to offer a business oriented lunch menu, but a more family friendly evening menu. The long business lunch is also on the decline with businesses favouring lighter, healthier and less liquid lunches. Health and safety legislation is also significant and food hygiene and cleanliness levels can be expensive to maintain, and even more expensive if they are not adhered to. Trends such as healthy eating, with an emphasis on fresher and more natural ingredients, is also on the increase, as is promoting the use of local produce. Costs can, however, be affected by aspects such as crop yields, or weather conditions, that is the physical environment, and seasonal factors need to be taken into account in menu design, particularly if using locally produced ingredients. Supply of labour is also governed by the minimum wage legislation. Many employees are not paid much more than the minimum wage and staff waiting tables often rely on tips to supplement their wages. Some restaurants pool their tips and share them among the staff equally, others allow individual staff to keep the tips they collect personally. A few restaurant chains have been criticised recently for retaining part of the tips as a corporate body, and not passing all of the tips on to the staff.

4. Sustainable Restaurants Inc. – original development and operation of the company

Sustainable Restaurants Inc. is part of B^2 Inc. The philosophy of Sustainable Restaurants Inc. was based on attention to detail and focus on quality. All ingredients were sourced locally from sustainable and organic producers. They worked very closely with the suppliers to ensure that the US environmental guidelines were followed, and that food was produced using sustainable, high benchmarked farming methods (that is, best practice), to high standards of animal welfare and low intensity, as opposed to the high intensity farming techniques used, for example, by many chicken farms. The 41 restaurants all serve lunch and dinner menus and would be classed as 'fine dining' restaurants.

Although they are all owned by Sustainable Restaurants Inc. they each have a different name and their own identity. There is a reference to Sustainable Restaurants Inc. on the restaurant paperwork, such as menus, receipts and letter headed paper, but many customers would not necessarily notice, unless they were specifically interested in who owned the restaurant. The restaurants are all situated in city centre or fashionable urban areas that can attract a range of business customers, as well as people going for a night out in the city. Four restaurants have Boutique Hotel rooms attached and, in these four restaurants only, breakfast menus are offered. A Boutique Hotel is a stylish small hotel, typically situated in fashionable urban areas. All of the restaurants are in amazing buildings which adds to the whole dining experience. The one downside to this is that the establishment costs are high, meaning the restaurants need to attract a reasonable volume of customers to break even.

Both Buck and Bethan are keen on staff development and have invested a lot of time and effort in training their staff. Bethan states that the restaurant business is as much about the people as it is the food. Having the right staff in the right jobs is a key element to delivering the perfect restaurant experience. The guests are in your hands from arriving and being greeted correctly to leaving and going safely on their way. The restaurants were all managed independently with a high degree of autonomy given to the staff, that is, they were not run as a chain of restaurants with common menus. Each Restaurant Manager and Chief Chef were given leeway to create the menu targeted for their particular location. There are similarities in the locations in that they are all in fashionable urban areas, with a good mix of residential and business accommodation. This ensures a good business lunch clientele can be attracted, as well as the evening diners. Buck encouraged the Chefs and Managers to exchange ideas and is known to have encouraged them to strike out on their own if they wish, and establish their own restaurant. This ensured that the key staff were always highly motivated and committed to trying new things, keeping the menu and restaurants fresh and current, whilst always adhering to the basic philosophy of high standards and quality.

The downside to this is that young talented Chefs do leave to start their own restaurants, which means that the reputation of the restaurant cannot be built around the Chef, but must be built around the total experience. One good aspect of the staff policies is that other staff tend to stay for a reasonable length of time, and some of the staff have been with the company since the restaurants in which they work opened. The Maitre D's (the people who ensure that the actual restaurant operation – front of house - runs smoothly during each lunch and evening period) are highly trained to recognise the characteristics of arriving guests and matching them to the server (waiter/waitress). They are also skilled at reading the restaurant, for example, determining whether the business lunch involved in a discussion can be left to wait a little longer between courses and offered more drinks, or are they keen to get in and out as quickly as possible? A good Maitre D' is able to give instructions to staff without being overheard by the customers.

Waiting/serving staff are trained to interact with customers to the right degree, knowing when customers want to be left alone, or when they like to be pampered with a very attentive waiter. Introducing themselves by name increases customer contact, and also the amount left as service charge – tips. Also making eye contact is an important aspect of establishing the right degree of rapport with the customer - not too familiar, but friendly, and above all professional.

The money invested in the training of staff is one of the factors why many staff tend to stay with the restaurant for a reasonable period of time, whereas in less well managed restaurants staff turnover is usually quite high. In the first year of employment, Sustainable Restaurants can spend up to 50% of the person's salary on training costs.

5. Restaurant operations

A good fine dining restaurant employs a range of staff, all with specific roles (these are shown in Appendix B for information). The number of staff members required is usually determined by the number of customers expected to be served in each hour. Some restaurants will employ staff on a flexible basis, for example, bar staff and servers (waiters and waitresses), may be needed depending on the number of advance bookings, however, some may be on call so that they can work at short notice. It is not unusual for some restaurants to bring in extra staff half way through an evening shift to cope with unexpected demand. However, Sustainable Restaurants operates a policy of certainty for staff and always has the necessary staff on duty to cope with a full restaurant. This can mean that occasionally staff are not fully employed but, due to the success of the restaurants and reputation, all restaurants are normally fully booked for every session. In the early days, as each restaurant became established and its reputation grew, it was unusual if customers were able to get a table without booking first.

All fresh ingredients are delivered on a daily basis from local suppliers. High standards of quality are expected and the General Managers and Executive Chefs work closely with local suppliers to ensure that quality standards are maintained. All suppliers must be approved and operate according to the sustainable philosophy of Sustainable Restaurants. Whilst these are very strict, suppliers have found that they can use the fact that they supply Sustainable Restaurants as a marketing message to capture other customers. Sustainable Restaurants do not rely on exclusive supply arrangements, as the downside to this is that it could limit their flexibility, and place too much reliance on a few suppliers. Sustainable Restaurants also believes that it is bad for their suppliers to put too much reliance on one customer. However, this does mean that they can be dealing with a number of different suppliers and a few General Managers have hinted that they would prefer to move towards a model of key supplier agreements on a more exclusive basis, in order to limit the number of suppliers with which they are dealing.

Stocks are managed carefully to limit wastage and menu items are adjusted to aid this process. Servers and customer facing staff are also briefed daily as to which dishes to recommend, which can influence customer choice, if done in the correct manner. Menus are drawn up on a daily basis and printed in-house. The

laundry service is outsourced, which includes the staff uniforms. It can be common in some restaurant for staff to be paid a laundry allowance and expected to wash their own clothes. Sustainable Restaurants, however, provide the uniforms and keep them clean, so that they are able to ensure that staff are always in clean, smart uniforms. The restaurants provide staff with changing rooms and showers (separate male and female rooms) and lockers.

Restaurants are designed so that they look busy but not crowded. Most of the restaurants have a capacity to seat 100 customers, with some having a smaller or larger capacity. The opening hours are such that they can accommodate early and late lunches, and early and late evening dinners. Popular times are pre theatre bookings (people eating out before going on to see a show or to an entertainment venue), and the mid evening meal times, for example, the eight o'clock table. The bookings are managed so that each table can be occupied at least twice every sitting, that is, twice at lunch time and twice in the evening. This requires staff to be highly trained in 'managing the customer through their meal', without the customer realising what is happening.

Taxi drivers know the restaurants well and the Hostess or Maitre D' can easily arrange a taxi very quickly for customers to get them home if they so wish. Customers that are feeling in a very good mood after being wined and dined to exceptional standards usually tip the taxi drivers well.

The restaurants undertake awareness advertising when starting up, but have found that word of mouth spreads quite quickly, and hotels are happy to recommend the restaurants, therefore, apart from the fees to be listed in restaurant guides, the need for high levels of marketing expenditure is low. Each restaurant has its own website and individual restaurant managers can adjust the content to reflect the local character and ambience (atmosphere and feel) of their particular restaurant. There is a Sustainable Restaurants website, but this is limited to corporate style information link to B^2 Inc. Although the restaurants are owned by the company each restaurant has its own identity consistent with fine dining restaurants, and they try to avoid being seen as a branded restaurant chain.

6. Pricing of menu items

Menu items in the industry are typically priced using the cost of food as the basis, and applying a multiplier to achieve a given profit, after making allowance for the overhead costs. This is typically cost plus pricing. However, there is an element of competitor pricing in that restaurants want to make sure that their prices are competitive, so a typical process would be to set a price for a main

course that would be attractive to the target market customers. There are elements of psychology involved in that certain foods are perceived to be expensive, and customers are happy to pay higher prices. For example, fish, such as salmon, is seen as more expensive than chicken dishes. However, salmon is frequently farm salmon, and is therefore relatively inexpensive as an ingredient, but the customer perceives them as being expensive with images of salmon battling up stream to find the home spawning grounds. So this means that some dishes can achieve a higher margin due to the cost of food being lower, but with a higher perceived price.

Typically the cost of the ingredients is calculated, including spices, cooking oils, and so forth. Allowances for delivery costs and return charges, if they are applicable, are added. Also allowances for 'drip loss' is made for certain foods, that is, cleaning of ingredients such as meat or fish, cutting, formatting, reduction during storage, cooling or heating. For example, to produce 330 grams of roasted beef, 500 grams of fresh beef is required. Restaurants then look for a margin on certain foods, based on value for money. Typically, in fine dining, the cost of food is between 38% and 42% of the meal price, whereas for a chain restaurant it is 30 – 35%. Therefore, the margin in a chain restaurant might be 65 – 70%, but lower in a fine dining restaurant. However, the margin has to cover the overheads costs such as labour, rent, marketing, taxes, other expenses such as, heating & lighting, equipment maintenance, administration, cleaning, and allowances for employee meals if provided, and unfortunately, but a sign of the times, an allowance for theft will be made. As a check on pricing the restaurant will then total the overheads and divide by the total number of meals served to arrive at a cost per meal. Crude, but effective.

Portion control is crucial, as once priced the restaurant has to make sure that every time a menu item is served it costs the same in food, in other words, the portions used are exactly the same. For example, if the meal was costed with 6 prawns then every time the meal is served, 6 prawns must be used – no more, no less. If a steak is advertised as 330 grams then 500 grams of raw steak must be used. An added complication comes from seasonal items as this can affect pricing. A good menu design will balance the low cost/high margin/low volume dishes, with the high cost/low margin/ high volume dishes. The key is getting the mix of dishes right as much as the individual prices. This only comes with experience and a great deal of trial and error. Margins can also be adjusted by manipulating the cost of side orders, or making starters more expensive, as many customers judge restaurant prices based on the price of the main course. Deserts are another way of improving the overall margin, particularly if waiters/waitresses can tempt the customer into having a desert. Adding small extra ingredients or naming of the dish can also be used to enhance appeal, and therefore, allow enhancement of the price. For example, smoked mackerel is nice, but hickory smoked mackerel with peach puree, almond crumble and buerre noisette gel can be priced at much more than the cost of the extra ingredients. Making more profitable dishes stand out on the menu can also be a good way of upselling meals, including recommendations and suggestions.

Part of managing a successful restaurant is being able to design a menu that maximises the profit of each sitting, therefore being able to adjust the mix of dishes is a critical success factor. This is where chain restaurants are able to find menus that work well by comparing performance across the chain of restaurants. Information about the mix of meals sold is just as important as the profit on each meal.

Overall margins can also be increased by the bar receipts as typically restaurants will charge 4 or 5 times the cost of the ingredients, for example, they can make a margin of 75% - 80% on drinks.

7. Current state of affairs - 2015

Buck and Bethan had been so wrapped up in developing the B^2 Inc. that they had left the running of Sustainable Restaurants to Alejandra, who is now a director of B^2 Inc, as well as CEO of Sustainable Restaurants. The summary financial statements from 2012 to 2016 are shown in Appendix A. The restaurant business did relatively well, but suffered a little during the recession following the 2008 financial crisis. Both Buck and Bethan had been impressed with how the restaurant business managed to survive during this time, when the market for fine dining was reducing, as customers traded down to less expensive options, and many restaurants were closing down. The performance picked up considerable in 2012 making an operating profit of 6.7%, but then saw a decline over the years to 2016. During 2013 Alejandra updated the kitchens disposing of much of the old equipment, and replacing it with more efficient, and surprisingly less expensive, modern equipment. Two restaurants have also been relocated, one in 2014 and the other in 2015.

The last year of 2017 was better with the operating profit increasing, but it was only in the order of 4%, which is lower than the 6% expected from the restaurant business. The business is financed from group resources and the majority of the liabilities and current assets are due to intercompany balances. The parent company guarantees the intercompany loans that are used to finance the business. This means that it is only the operating profit that is of any real meaning as to the performance of the business, as the finance costs and taxation is distorted by the intercompany transactions.

Buck and Bethan were pleased that the performance is picking up. However, they had noticed that there appeared to be more similarity between the menus than there used to be. This took a while to notice, as Buck and Bethan only manage to visit each restaurant about once a year. They had also noticed that the restaurants were not as busy as they used to be. Buck's renewed interest had also been stimulated by a critic's article in a popular restaurant that suggested that Sustainable Restaurants has slipped from being a collection of fine dining restaurants under common ownership, to becoming a restaurant chain. In the restaurant business this can be seen as a derogatory comment (that is, not very complementary), as fine dining restaurants do not like to be referred to a restaurant chain, which is characterised by standardisation and common branding. This had implications for the brand image. Buck decided to talk to some of the long serving staff in several of the older restaurants with which he had been involved in establishing in the early days. He found that the Chefs had been encouraged to introduce a degree of standardisation within the menus, and the supplier arrangements had been changed to feature a few key suppliers in an attempt to reduce the supply chain costs. Staff numbers had been reduced, mostly by not replacing staff if they left in non-key positions, for example, not replacing waiting staff or line Chefs. Menus were now printed by a national low cost, high volume, printing company. When Buck spoke to Alejandra about the changes he could see the logic of the decisions, and realised that it was the basis for retaining the profitability of the restaurants in the difficult economic times. He was, however, worried about the impact that it was now appearing to have on the reputation of the restaurants, and the original vision of fine dining. Alejandra had managed to make savings in the operation by introducing elements of standardisation, whilst still retaining the sustainable ethos, but inevitably some of the emphasis son locally sourced produce had been reduced by changing to national suppliers. Buck was very realistic about the state of things and has asked Alejandra to draw up a plan for the future of the restaurants. He was quite open minded and suggested he was happy to invest money in them to bring the operations up to fine dining standards again, or if the best way forward was to develop them as a restaurant chain with standardisation and a common brand, he was perfectly happy to consider this as an option. They agreed that the future of the restaurant chain would be discussed at the next Board meeting.

8. Potential opportunity - Leisure pursuits and hotel / conference complex in Charming Heights

Bethan has been working on a project to develop a piece of land at the edge of a forestry area purchased by B^2 Inc for $2M a year ago. The land borders on a medium sized town called Charming. The plan is to create an outdoor leisure pursuits centre, with a hotel and holiday homes complex. The hotel and holiday homes would be built of sustainable materials and powered by a wind turbine. The outdoor pursuits would take full advantage of the forestry land and manmade lake that is central to the forestry area. The lake was built some years ago to manage the surface water from the local town, that is, the excess rain water from the roads is filtered and fed into the lake. This prevents the local drainage system from being overwhelmed by high volumes of water. Part of the deal when the forestry land was purchased included a commitment to maintain the lake for its original purpose.

The local residents have lodged an objection to the planned leisure centre and hotel complex fearing that local traffic would increase and that the use of the lake for leisure purposes will take priority over its original purpose, causing local flooding if the town’s drainage system cannot cope with the excess water during

heavy rain, which it is prone to do in the region. However, B^2 Inc. has predicted and stressed that the plans will increase employment and boost the local economy. Bethan has pointed to the philosophy of sustainability that the company has at the heart of its vision, and pledges to work with the local community to protect the wildlife and landscape in its original form. The objective is to allow visitors to enjoy the natural beauty of the area whilst pursuing outdoor activities.

Appendix A – Summary Financial Statements for Sustainable Restaurants Inc.

Income Statement (Profit and Loss Account) for the 52 week period ended 31st December

	2017	2016	2015	2014	2013	2012
	$	$	$	$	$	$
Turnover	47,846,775	45,558,261	46,508,472	49,269,447	51,355,121	51,803,825
Cost of sales	(14,164,639)	(13,756,068)	(14,191,150)	(14,455,588)	(14,873,890)	(15,391,651)
Gross Profit	**33,682,136**	**31,802,193**	**32,317,322**	**34,813,859**	**36,481,231**	**36,412,174**
Administrative expenses	(31,802,877)	(29,834,308)	(31,548,229)	(33,201,603)	(33,156,264)	(32,439,743)
Operating Profit	**1,879,259**	**1,967,885**	**769,093**	**1,612,256**	**3,324,967**	**3,972,431**
Exceptional items						
Net loss on disposal of investments/assets	-	(1,331,494)	-	-	(2,055,676)	(505,494)
Profit on ordinary activities before interest	**1,879,259**	**636,391**	**769,093**	**1,612,256**	**1,269,291**	**3,466,937**
Income from fixed asset investments and other participating interests	41,794	-	-	57,666	-	-
Interest received and similar income	206,766	235,270	140,060	93,977	2,871	41,121
Interest payable and similar charges	(464,420)	(539,164)	(494,327)	(405,978)	(1,103,362)	(3,085,940)
Profit on ordinary activities before taxation	**1,663,399**	**332,497**	**414,826**	**1,357,921**	**168,800**	**422,118**
Tax on ordinary activities	(406,716)	(503,655)	(161,834)	(894,677)	(1,045,015)	(854,866)
Profit/(Loss) for the financial period	**1,256,683**	**(171,158)**	**252,992**	**463,244**	**(876,215)**	**(432,748)**

Summary Balance Sheets as at 31st December

	2017	2016	2015	2014	2013	2012
	$	$	$	$	$	$
Fixed Assets						
Tangible assets	24,346,192	25,785,940	25,337,814	26,999,471	29,207,444	32,454,881
Investments	250,000	250,000	1,581,494	1,581,494	1,493,524	988,497
	24,596,192	**26,035,940**	**26,919,308**	**28,580,965**	**30,700,968**	**33,443,378**
Current assets	15,549,310	12,644,061	11,130,564	7,513,599	4,807,272	3,961,065
Current liabilities	(29,284,452)	(28,821,640)	(28,082,645)	(26,499,507)	(26,631,655)	(28,387,217)
Net current liabilities	**(13,735,142)**	**(16,177,579)**	**(16,952,081)**	**(18,985,908)**	**(21,824,383)**	**(24,426,152)**
Total assets less current liabilities	**10,861,050**	**9,858,361**	**9,967,227**	**9,595,057**	**8,876,585**	**9,017,226**
Provisions for liabilities						
Deferred tax	(1,772,635)	(2,026,629)	(1,964,337)	(1,845,159)	(1,589,931)	(854,357)
Total assets less current liabilities being net assets	**9,088,415**	**7,831,732**	**8,002,890**	**7,749,898**	**7,286,654**	**8,162,869**
Capital and reserves (Equity)						
Called up share capital	839,600	839,600	839,600	839,600	839,600	839,600
Share premium account	659,400	659,400	659,400	659,400	659,400	659,400
Profit and loss account	7,589,415	6,332,732	6,503,890	6,250,898	5,787,654	6,663,869
Shareholders' funds (Total equity)	**9,088,415**	**7,831,732**	**8,002,890**	**7,749,898**	**7,286,654**	**8,162,869**
Note: current liabilities includes amounts owing to other group companies	(28,667,035)	(28,380,277)	(28,082,645)	(21,648,061)	(20,659,940)	(20,800,848)
The majority of the current assets are also made up of intercompany balances.						

Appendix B - Staff in the restaurant

(source - http://everydaylife.globalpost.com/restaurant-staff-job-descriptions-1785.html)

Management

A general manager is responsible for overseeing the general operations of the restaurant. He and his assistant manager – if he has one – hire staff to serve in the front of house (FOH), and to cook in the back of house (BOH). The management team carefully monitors the profit and loss statements of the restaurant and works closely with the executive chef to provide a cost-effective menu for patrons. The manager and assistant manager often have college degrees and experience in the food service industry. Managers need good communication skills and leadership qualities to ensure the restaurant operates efficiently.

Back of House

The executive chef is responsible for coordinating the menu and monitoring food costs. His culinary experience enables him to create new dishes to add to the menu. The chef de cuisine assists the head chef with day-to-day kitchen operations. He supervises the prep and line cooks, who prepare the food and cook it. The sous chef is responsible for training new cooks and BOH staff while the pastry chef handles the dessert offerings. The dishwasher has the task of keeping the dishes, pots and pans clean. He often has the responsibility of keeping the kitchen clean and the dishwashing equipment operational.

Front of House

The Maître D' works closely with all the staff members to ensure good communication between the wait [serving] staff and the kitchen. In addition to overseeing the general operation of the dining room, the Maître D' ensures that customers have a good dining experience. The Maître D' is often responsible for managing the restaurant's reservation system. Some restaurants use a host or hostess in lieu of a Maître D'. The expediter or expo fills orders and checks to make sure they are correct in the kitchen, then hands off the orders to the food runner who transports the food to the dining room. The servers [waiters and waitresses] then present the food to the diners. When diners finish their meals, bussers clear the tables and take the dishes to the kitchen for the dishwasher to clean.

Bar

In restaurants with a bar, a bartender mixes and prepares drinks. A sommelier recommends wines to diners based on their food selections. Both the bartender and sommelier need to be familiar with the products they sell, and both may be responsible for maintaining the restaurant's alcohol inventory. The assistant manager often oversees this part of the operation.

Typical restaurant staffing in Restaurant Chains (Extract)

	Customers per hour					
	10	25	50	75	100	150
Front of House						
Server	1	2	4	5	7	10
Busser	0	1	1	2	2	3
Bartender	1	1	1	1	2	2
Hostess	0	0	1	1	2	2
Back of House						
Line cooks	1	2	3	3	4	6
Dishwasher	1	1	1	1	1	2
Expeditor	0	0	0	1	1	1

Note that Sustainable Restaurants Inc. being a fine dining restaurant employs staff in excess of this – as a rough guide fine dining restaurants will employ staff levels in the column two to the right of the number of customer per hour. For example, 7 servers for 50 customers per hour, and 4 line cooks instead of 3, and so forth. The staff costs are therefore higher.

End of case study material

QUESTIONS

Question 1 –Environmental analysis

Required:

(a) Discuss how undertaking an environmental analysis can assist the management of Sustainable Restaurants Inc. in developing its future strategy.

(b) Utilising models and frameworks of your choice, prepare an environmental analysis for Sustainable Restaurants Inc.

(c) Critically evaluate how the management accountant can contribute to an environmental analysis.

Question 2 – SWOT analysis

Required:

The Board of Directors are undertaking a strategic review of the company.

(a) Prepare a corporate appraisal (SWOT analysis) for Sustainable Restaurants Inc. that will help them formulate a future strategy to develop the company.

(b) Critically evaluate the contribution that the management accountant of Sustainable Restaurants Inc. is able to make to the development and evaluation of strategic options.

Question 3 – Stakeholders and stakeholder mapping

Johnson and Scholes (1997) identified that one of the three tests that should be carried out when assessing whether a strategic option should be undertaken by an organisation is the acceptability to stakeholders test (stakeholder analysis).

Required:

(a) Critically discuss the components and process of a stakeholder analysis and the benefits that would accrue to B^2 Inc. from applying such an analysis. (Note this question refers to the parent company of B^2 Inc, not just Sustainable Restaurants).

(b) Undertake a stakeholder analysis by identifying the principle stakeholders in the decision to open a leisure park and hotel complex being contemplated by B^2 Inc. Justify their level of interest and significance in influencing the decision of the Board of Directors of B^2 Inc. and recommend a suitable strategy for managing each stakeholder group you discuss.

Question 4 – Customer profitability analysis – Hotel

The Board of B^2 Inc. are considering the pricing of the hotel rooms and conference facilities. They believe that the most profitable visitor will be the Business and Conference Centre user as traditionally they are likely to spend more money in the hotel than holiday makers, who typically spend more time site seeing and visiting the local town.

Best estimates are provided as follows:

Number of rooms	400
Occupancy	85%

The Hotel is open 365 per year.

Number of rooms occupied	340
Days in year	365
Total number of days occupied	124100

Note - all rooms are capable of accommodating 2 guests

Type of customer	Holiday	Business	Conference	Total
Proportion of rooms utilised	60%	15%	25%	
Number of days rooms are occupied per annum	74460	18615	31025	124100
Expected number of guests per room – based on number of adults – no charge is made for children.	2	1	1	
Expected number of guests per annum	148920	18615	31025	198560
Average stay length nights	5	2	1	
Number of bookings	14892	9307.5	3000	27199.5
Average number of meals in restaurant per guest	1.5	2	3	
Number of meals consumed on site	223380	37230	93075	353685
Average price of meal consumed	$35	$75	$40	
Average Room price per guest per night	$125	$112	$100	
Extras purchases per guest. For example, gift shops and concession fees earned from onsite hairdressers, beauty salon and leisure clothes shop and other retail entities.	$25	$15	$10	

The prices are based on a 10% discount for Business guests and 20% for conference centre users.

The conference centre is expected to generate revenue of $2,500,000 from hire charges and costs of $2,200,000 are expected to be incurred to operate the conference facilities.

The total costs of running the Hotel are expected to be $37,000,000 p.a. A break down is shown below together with a suggested basis for allocating costs to different customer types.

Costs		$	Basis of allocation
Reservation and reception front desk costs	1%	370,000	No of bookings
Cleaning	3%	1,110,000	Number of days rooms are occupied per annum
Laundry	10%	3,700,000	Number of days rooms are occupied per annum
Provision of free transport bus, garage and parking	1%	370,000	Number of guests – typically all guests use the free transfer bus provided or the secure car park
Guest room supplies, toiletries	1%	370,000	Number of guests
Food and beverage (restaurants and bars)	45%	16,650,000	Allocate based on meals consumed
Admin and general expenses	28%	10,360,000	Not allocated
Marketing *	6%	2,220,000	Allocated based on specific campaign (see below)
Gift shops - costs, including cost of goods	5%	1,850,000	Allocate based on cost of extra purchases made by guests
Total	100%	37,000,000	

* Marketing campaigns are follows:

Marketing costs for holidays at the leisure park	$1,110,000
Marketing costs for business customers	$444,000
Marketing costs for conference centre	$666,000

Required:

Customer profitability analysis is more popular in marketing texts than accounting texts, yet it relies on accounting information for the calculation. The marketing director is keen to use the technique as a tool in the management of the hotel should the acquisition go ahead.

(a) Critically evaluate CPA as a technique for the management of a customer portfolio, that is, a mix of customer categories.

(b) Utilising the information provided above relating to the Hotel and Conference Complex planned by B^2 Inc. demonstrate how customer profitability analysis could be used in identifying the potential profitability of different customer groups, that is, calculate the relative profitability of the customer groups identified. Comment briefly on the results.

Question 5 – Balanced scorecard

It has been suggested that the Balanced Scorecard, as developed by Kaplan and Norton would be an appropriate model with which to monitor the performance of the company in the future.

Required:

(a) Critically evaluate how the Balanced Scorecard model, developed by Kaplan and Norton, will assist the Board of Directors of Sustainable Restaurants Inc. in evaluating the company's performance.

(b) Develop a Balanced Scorecard for Sustainable Restaurants Inc. which reflects its strategic objectives, particularly those relating to sustainability. You must include:

- (i) Specific objectives (minimum of eight objectives and at least one objective per perspective) together with a performance indicator (measure) for each objective.
- (ii) Appropriate initiatives for each perspective to help achieve the objectives.

Question 6 – Investment appraisal and strategic options

Refurbishment of restaurants as a restaurant chain under the common brand of Sustainable Restaurants.

Buck has asked Alejandra to prepare a paper for the Board meeting evaluating the option to rebrand the restaurants as a restaurant chain to promote the Sustainable Restaurants brand. There is a feeling that in the current business climate, and with an increased focus on sustainability issues, the brand might do quite well as it taps into consumer sentiment and concerns about climate change, healthy eating and sustainability issues in general.

Alejandra has made the following estimates of costs and revenues for the rebranding of 41 restaurants as a restaurant chain.

Cost and revenue estimates are as follows:

Refurbishment of all 41 restaurants to the same standard and decor (treat as incurred in year 0)	$100,000 per restaurant
Investment in branding, e.g. signage and changes to stationery (treat as incurred in year 0)	$2,500 per restaurant
Investment in new technology, such as EPOS tills linked to ERP system (treat as incurred in year 0)	$5,000 per restaurant
Training costs for staff in the first year of operation	$20,000 per restaurant
Training costs in second year of operation and subsequent years of operation	$5,000 per restaurant p.a.
Increase in cost of material due to move back to local suppliers	$25,000 per restaurant p.a.
Marketing costs to re-launch incurred immediately (treat as year 0)	$500,000 in total
Marketing costs in year one and subsequent years	$250,000 p.a. in total
Increase in revenue each year	$50,000 per restaurant p.a.
Saving in salary costs in first year only	$50,000 per restaurant

The investments are usually evaluated over a 5 year period and the cost of capital is estimate to be 7%.

Costs are expected to rise by inflation each year which is expected to be 2% per annum (for planning purposes assume that costs given above, unless otherwise stated, are for their first year of inclusion in the analysis and that inflation takes effect in the following years, for example, training costs in the second year are

$5,000 per restaurant in year 2 with inflation affecting the costs in the years following.

Revenue is expected to increase by 10% per annum.

Ignore taxation

Required:

(a) Utilising the information provided prepare a financial evaluation using a NPV calculation of the proposal to rebrand the restaurants as a restaurant chain.

(b) Discuss what other information of a non-financial nature you would require to provide a full strategic evaluation of the proposal before making your final recommendation.

(c) Utilising Ansoff's growth matrix as a theoretical framework critically evaluate the merits of rebranding the restaurants as a growth strategy compared to the strategy of diversification if the leisure park and hotel option is approved.

Question 7 – Competitive strategies

Required:

(a) Critically evaluate the competitive strategies of differentiation and cost leadership with reference to their suitability for Sustainable Restaurants Inc., particularly if the rebranding option is approved. Include examples of how Sustainable Restaurants could achieve either cost leadership in its chosen market, or differentiate itself from the competition.

(b) It is suggested that the management accountant is able to support the executive management of a company by applying management accounting techniques and strategic planning models/frameworks.

Critically evaluate any **ONE** of the techniques and models/frameworks listed below illustrating how they will help support the Board of Sustainable Restaurants in developing and executing its future strategy. You should briefly explain the technique before evaluating its usefulness to Sustainable Restaurants.

Any **ONE** of:

1. Value chain analysis
2. Target costing
3. Balanced Scorecard

Question 8 – Investment appraisal

As part of their strategic review the Board of Directors are assessing the strategic options available for the future development of the company. One option is to invest in the development of the Leisure Park and Hotel site. Khalid Abdurrahman, the accountant, has asked you to assist in the appraisal of this particular option.

Estimates for the building and operation of the leisure pursuits and hotel/conference complex in Charming Heights.

The costs of building the centre and getting it ready for operation will take about one year and the costs are anticipated to be:

Building costs for hotel and accommodation: $50,000,000
Initial marketing costs prior to opening: $2,500,000
Cost of outdoor facilities on the lake e.g. boat house for surf boards and boats: $10,000,000
Cost of building trails and adventure playground: £1,000,000
Cost of equipment for use by visitors, e.g. canoes, windsurfing boards, life jackets, bicycles: $5,000,000

All these costs will be incurred during year 1 before opening the centre to visitors.

Normal deprecation rates applied by B^2 Inc are:

Land and buildings 2% p.a.
Equipment: 20% p.a.

The centre will take one year to build and will operational at the beginning of year 2 of the project.

The latest estimates that have been provided by a market research company.

Number of day visitor entry fees collected in the first year of operation are estimated as:

1,000,000	probability	0.3
1,250,000	probability	0.6
1,500,000	probability	0.1

For the purpose of evaluation entry fees are expected to be $25 per adult per day. Family fees, i.e. two adults plus up to four children $75. Of the visitors it is expected that 40% will be family visitors, the rest will be charged as individual adults. (Note that the estimated figures above are for entry fees collected, i.e. 40% of the number will be charged at $75, 60% at $25.) It is expected that each visitor will spend approximately $15 on hire of equipment, and $20 on food and drink per day whilst visiting the centre. (For this purpose assume that the average family consists of 4 people, i.e. number of family visitor entry fees x 4. This when added to individual adult entry fees will provide an estimate of the number of people visiting each year).

The cost of operating the leisure facilities is expected to be in the order of $140,000,000 p.a.

The hotel and accommodation will have 400 rooms and it is anticipated that they will achieve occupancy rates of 85% on average. The hotel and accommodation will be available 365 days per year. The average price of a room to be achieved based on a normal mix of single, double and family occupancy is estimated to be $125 per night. Restaurant and bar revenue from the five restaurants and bars are expected to be on average approximately $25 per guest. For investment appraisal purposes and based on the figures provided here the expected revenue has been estimated at around $44,000,000 p.a. (this figure is to be used for the investment appraisal).

There will also be a conference facility that will have five conference rooms together will various smaller breakout rooms available and a main theatre. As an estimate it is hoped that this facility will yield revenue in the order of $2,500,000 p.a. in hire charges. Note: conference delegates are able to stay in the hotel. For the purposes of evaluation these are included in the figures above already estimated for the hotel accommodation.

The costs of operating the conference facilities is expected to be $2,200,000 per annum; the cost of the hotel and accommodation and restaurants is expected to be $37,000,000 p.a.

After the first year of operation all revenues generated are expected to increase by 10% p.a. and costs to rise by 2% p.a.

Taxation is to be ignored. The company has an average cost of capital of 7% and projects of this nature are usually evaluated over an operational period of five years.

Assume all costs are incurred at the end of the year unless otherwise stated.

Required:

(a) Utilising the information provided prepare a financial evaluation, using Net Present Value, of the Leisure Park and Hotel option. (State any assumptions made.)

(b) Discuss other factors of a strategic nature that you would take into account when evaluating this potential option.

Question 9 – Activity-based costing

The restaurant pricing

The manager of the most recent restaurant to open is looking at the pricing and costing of meals, and has expressed an interest in activity based costing as an aid to pricing meals. He noticed that the high cost meals typically take longer in terms of staff time for preparation and cooking, than the low cost meals.

The current basis of pricing is to base the price purely on the material cost, which assumes that labour is the same for all meals. He has asked for your help and provided you with the following information. Typically restaurants calculate the material costs, and then work out the gross margin to calculate the price. The total overheads are then divided by the number of covers served (a cover is the term used for a person ordering a complete meal and essentially equates to meals served) in the year to calculate an overhead cost per meal. This provides a profit per meal figure.

	Low cost meal	High cost meal
Price	50	100
Material cost	10	35
Typical gross margin expected to be earned	80% of price	65% of price

The information about number of meals served per annum is provided below.

No of days per year the restaurant is open per annum	365
Average no of covers (meals served) per day	65
Average number of persons per table	5

The total overheads are $775,000 per annum.

The labour cost which is part of the total overheads above can be analysed between the following activities.

	$
Total labour cost included in the $775,000 costs per annum are:	384,000
Breakdown of labour costs Receiving and storage	13,056
Preparation and cooking	185,472
Front of house (welcome and service)	132,480
Cleaning	14,592
General admin	38,400

However, on further analysis it is only the preparation and cooking time that varies per dish. The other costs can be allocated on a cover (meal served) basis.

It is estimated that 60% of total meals served will be high cost meals, and 40% will be low cost meals.

Time per meal - prep and cooking hours	
Low cost meal	0.5 hour
High cost meal	1.5 hours

The breakdown of overheads and basis of allocation suggested is given below:

Overhead allocation	$	
Labour prep and cooking	185,472	per hour
Other labour	198,528	per cover (meal)
Depreciation of equipment	70,000	per cover (meal)
Operating Leases	112,000	per cover (meal)
Cleaning	15,000	per cover (meal)
Energy - Kitchen	50,000	per cover (meal)
Maintenance of equipment	25,000	per cover (meal)
Energy - Front of house	25,000	per table
Admin and misc	20,000	per table
Marketing	25,000	per table
Printing	10,000	per table
Communications and IT	15,000	per table
Laundry	24,000	per table
Total overheads	775,000	

Sustainable Restaurants Inc. has traditionally priced meals by taking the cost of ingredients (food) and applying a percentage to cover overheads and profit. The percentage to apply can vary depending on the main ingredient. For example, pasta dishes are traditionally low cost with high margin (70%) whereas specials such as lobster are high cost, low margin (50%). Khalid Abdurrahman, the company accountant, in response to the request from the restaurant manager, wants to undertake an ABC exercise to investigate whether there is a better way of pricing meals.

Required:

Critically evaluate ABC as a costing technique and its potential suitability for restaurants

(a) Using the information provided calculate the profit margin made on a typical low cost meal and a high cost meal, AND the profit per table if a typical table consists of 2 low cost meals, and 3 high cost meals using:

(i) the current basis of pricing; and

(ii) if ABC is used to allocate overhead costs (that is, allocate costs using an ABC method, and assume prices are the same in part (i).

(b) Critically evaluate ABC as a method of costing for the restaurant, highlighting the key benefits to the management of Sustainable Restaurants Inc that may be gained from using the method, and any difficulties that may be encountered during the implementation.

Question 10 – Benchmarking

Jamila Abadu, one of the young up and coming Chef's, recently attended a restaurateur's convention at which one of the speakers mentioned the use of benchmarking. Jamila was aware that the restaurants checked their prices against other competitor restaurants in the local areas, but was unaware of the wider benefits of benchmarking. She has asked you to prepare a short paper on benchmarking that she can use as a basis of discussion with Alejandra.

Required:

(a) Critically evaluate benchmarking as a technique for improving the profitability of Sustainable Restaurants Inc.

(b) Provide advice to the management of Sustainable Restaurants Inc. on the types of benchmarking that could be used. Illustrate your answer with examples of areas of the business or activities that could be benchmarked.

(c) Provide advice on the stages of conducting a benchmarking exercise in the context of Sustainable Restaurant Inc.

Question 11 – Sustainability and costs of quality

Sustainable Restaurants Inc. have based their competitive strategy on providing high quality from sustainable sources.

Required:

(a) Critically evaluate how the management accountant can contribute to the achievement of sustainability objectives and reputation of Sustainable Restaurants Inc.

(b) Critically evaluate how highlighting the costs of quality in reporting to management will aid the maintenance of its competitive strategy. You should utilise examples of items that could be reported under each cost of quality heading typically used in cost of quality reports.

Present Value Table

Present value of 1 ie $(1 + r)^{-n}$ Where r = discount rate, n = number of periods until payment.

Discount rates (r)

***Periods* (n)**	**1%**	**2%**	**3%**	**4%**	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239

	11%	**12%**	**13%**	**14%**	**15%**	**16%**	**17%**	**18%**	**19%**	**20%**
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.169	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065