Key Financial Terms in a Restaurant Environment

## 1. Cost of Goods Sold (COGS):

Formula:
COGS = Beginning Inventory + Purchases - Ending Inventory

Explanation: This formula calculates the total cost of the products sold during a specific period. It includes the initial inventory, any additional purchases, and subtracts what remains in inventory at the end. COGS is critical for understanding the direct costs associated with food and beverage sales.

## 2. Gross Profit:

Formula:
Gross Profit = Total Sales - COGS

Explanation: Gross Profit represents the profit made after subtracting the cost of goods sold from the total sales. It shows how much money is left to cover operating expenses, taxes, and profits.

## 3. Prime Cost:

Formula:
Prime Cost = COGS + Total Labor Costs

Explanation: Prime Cost combines the cost of goods sold with total labor costs, which are typically the two largest expenses for a restaurant. Keeping Prime Cost under control is essential for maintaining profitability.

## 4. Overhead:

Formula:
Overhead Costs = Total Fixed Costs + Total Variable Costs

Explanation: Overhead costs are ongoing expenses that are not directly tied to the production of goods or services, such as rent, utilities, and salaries for administrative staff. Understanding overhead helps in pricing and financial planning.

## 5. Contribution Margin:

Formula:
Contribution Margin per Unit = Selling Price per Unit - Variable Cost per Unit

Explanation: Contribution Margin shows how much money each unit sold contributes to covering fixed costs and generating profit, after the variable costs are subtracted.

## 6. Break-Even Point:

Formula:
Break-Even Point (in units) = Total Fixed Costs / (Selling Price per Unit - Variable Cost per Unit)

Explanation: The Break-Even Point is the number of units that must be sold to cover all costs, resulting in neither profit nor loss. It’s a critical metric for understanding the minimum sales required to avoid losses.

## 7. Cash Flow:

Formula:
Net Cash Flow = Total Cash Inflows - Total Cash Outflows

Explanation: Net Cash Flow measures the difference between cash coming into the business and cash going out. Positive cash flow ensures that the restaurant can meet its financial obligations and invest in growth.

## 8. Food Cost Percentage:

Formula:
Food Cost Percentage = (COGS / Total Food Sales) × 100

Explanation: Food Cost Percentage indicates what portion of food sales is consumed by the cost of food ingredients. It’s a key metric for managing food costs and pricing menu items effectively.

## 9. Labor Cost Percentage:

Formula:
Labor Cost Percentage = (Total Labor Costs / Total Sales) × 100

Explanation: Labor Cost Percentage measures the portion of total sales spent on labor. It’s crucial for managing staffing levels and maintaining profitability.

## 10. Net Profit Margin:

Formula:
Net Profit Margin = (Net Profit / Total Sales) × 100

Explanation: Net Profit Margin shows the percentage of total sales that remains as profit after all expenses, including COGS, labor, overhead, taxes, and interest, have been deducted. This metric indicates how efficiently a restaurant is converting sales into actual profit and is essential for assessing overall financial health.