

“GOOD, FAST, & CHEAP: IT’S A MARGIN CALL!”

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After working several retail and restaurant jobs, Paul Stanley was finally living his dream. He had saved enough money to open a restaurant. His passion was seafood; he loved being in the kitchen and creating new and exciting dishes for his customers. Although they had only been open six months, the restaurant, Stan’s Seafood, was always busy. Stanley was proud of the food they served. His patrons told him that he had the best seafood for the price. When Stanley started the business, he decided to take care of the paperwork and pay the bills to save the expense of hiring an accountant. Unfortunately, Stanley’s pride in the success of his restaurant was tempered by the lack of results in his company checkbook. At first, Stanley was not too concerned, but as the months passed, he began to feel the pressure of opening a checkbook that never seemed to have enough. Things looked bleak. Stan had poured his life savings into the restaurant; the thought that his dream would run out of money and go bankrupt was too much. But, before it was too late, he had to understand why his seemingly successful business was tanking. While Stanley could work wonders in the kitchen, he had little experience in the financial aspects of the company. To better understand why his financial results were so poor when his restaurant was consistently busy, Stanley decided it was time to get advice from a trusted source, his former professor and Certified Public Accountant, Dr. Ron Blair. Stanley must get advice and act fast to make necessary adjustments to keep his business afloat and improve performance.

INTRODUCTION

It was early morning on a beautiful spring day in early April 2014. Paul Stanley, the owner of Stan’s Seafood, pulled into the shopping center parking lot where his restaurant was located. Usually, Stanley felt a great sense of pride when he arrived

at work. His dream of owning his restaurant had finally become a reality. He never thought he would be able to open his seafood restaurant. However, today, he was not in the best of moods. He arrived early this morning to pay the bills for his raw seafood. The bills and other items had formed an impressive pile on his small desk in the back of the restaurant. While Stanley always enjoyed being in the kitchen creating fabulous meals for his clients, he despised the administrative aspects of owning his own business. Sitting down to complete the task, he felt a knot in his stomach. In anticipation, his hands started to tremble. He was afraid of what he would find. In the previous months, his account ended with a lower balance than he had started with. As he wrote out the checks for the prior month's purchases, he was stunned when he saw the balance had fallen to under \$10,000. Dwindling money in the bank and a net operating loss was catastrophic to any company, especially a new and aspiring one. Stanley was baffled! He could not comprehend how his restaurant could steadily increase sales but perform at a net loss. As his eyes filled with tears, he knew he had to do something and fast. Seeing his dream of owning his seafood restaurant fail was unimaginable. Stanley had invested his life savings in the restaurant. To make matters even more desperate, he had not left himself with any additional funding. If he did not find out why this was happening and make the necessary adjustments soon, the dream of Stan's Seafood would be a financial nightmare! His financial nightmare would inevitably become an unthinkable reality.

BACKGROUND

Having opened his new restaurant six months ago, Stanley knew he had the culinary skills necessary for a successful restaurant. Stanley had cooked at several coastal eateries for the past fifteen years and saw firsthand how customers would flock to a location that served fresh, quality seafood. He had built relationships with a group of coastal fishermen and had contacts for other needed groceries and staples. As Stanley set upon designing and pricing his menu, he traveled to several local restaurants to review their offerings and menu prices. He was confident he could offer superior taste and quality, two essential ingredients that would set him apart from his competitors. Unfortunately, a common error for a new business owner was basing the sales price solely on market comparisons without a cost analysis. This misstep could damage the business's future before it could carve out its niche in the market.

THE DILEMMA

After writing out the checks to his suppliers and for other bills, Stanley looked at the balance in his business account. In the last six months, he went from \$30,000 to less than \$10,000. He sat silently, head in his hands, what would become of Stan's Seafood. After a few minutes, Stanley thought he had better call his wife, Jennifer Stanley, and give her the news. Jennifer had always supported Stanley and

had gone all in on his dream. Knowing that Stanley had always worked long and hard to get the restaurant going, she always tried to be as upbeat as possible. “Hi, honey,” she answered. “How is the day so far,” she said cheerily. As soon as Stanley started to speak, Jennifer sensed the urgency in his voice. “Hi, sweetie,” Stanley sighed. He continued, “I am not sure what is going on. We have been super busy nearly every night. Sales are improving weekly, but we never seem to have enough to cover all the bills. I just paid the bills for March, and we are down to less than \$10,000 in the account.”

Jennifer knew that the restaurant had been going through some money in the business, but this was the first time she was concerned. More importantly, she could sense that Stanley was also concerned. Jennifer tried to be upbeat. “You are a great chef, and people love your food. I am sure you will get it sorted out.” Frustrated, Stanley replied, “You know, I think I would have been better off to have left off cooking and left all these headaches to someone else.” He continued, “I love the cooking, but this worrying about money and paying the bills is killing me.” Jennifer was quiet, considering what her husband had just said. She knew he was angry and scared but believed that if he gave up on his dream, he would regret it. Finally, she replied, “Do you remember what you always told me? You always said that fresh food makes the difference, and your customers know what great food you have.” Stanley agreed but replied, “Much good that will do when we run out of money.” Undeterred, Jennifer spoke calmly and smoothly to her upset husband. “Look, honey, the sales have been increasing. The customers love your food. So there must be something else causing you to be unable to pay the bills.”

Stanley left the restaurant late that night. As he got into his car, he sat momentarily and thought. The restaurant was hopping all night long. The tables were full. The customers were happy. The waitstaff was doing well with their tips. He thought, “How could everything go so well on one end and his checkbook be so bad on the other?” There must be an answer. If he did not figure it out soon, his dream of owning a seafood restaurant would vanish like flotsam being drawn out with the tide.

Stanley had trouble sleeping that night. He tossed and turned. Unable to sleep, he sat at the kitchen table looking at some photographs from the opening night at Stan’s Seafood. Turning the pages, he stopped and stared at one of the photos. It was of a group of friends from Campbell University. He thought about how great that night was and how everyone was so happy for him finally achieving his dream. He looked closer and noticed one of his professors, Dr. Blair, among his friends. Dr. Blair was an Accounting Professor and CPA. Although Stanley struggled mightily in his class, he had always liked Dr. Blair and frequently visited him for help with his assignments. A light went off in his head! He remembered Dr. Blair

had owned several businesses before beginning his academic career. He could not help but believe that Dr. Blair could help him figure out what was happening to cause him to continue to lose money.

A PLAN FORWARD

Dr. Blair was surprised to see an email from Stanley. It had been a couple of years since he had been a student in his class. He remembered him well and recalled attending the opening night at his seafood restaurant. He also remembered that Stanley had not been the best student but was always willing to work to improve. Dr. Blair could tell by the tone of his email that Stanley was panicked and concerned about what was happening in his business. In his email, Stanley said he was available most mornings before the restaurant was open, so Dr. Blair decided to pick up the phone and call him.

Once he had Stanley on the phone, the two exchanged pleasantries and inquiries about the years since they had last seen each other. After a few minutes, Dr. Blair asked, "So Stanley, what is happening with the business?" Stanley replied that the business had been going well and sales had been increasing every month, but for some reason, he seemed to have less and less money in his business checking account. Dr. Blair was all too familiar with this issue. Many of his clients were small and medium-sized business owners who were quite skilled in their area of expertise but often did not have the time necessary to understand the financial end of the business. After listening to Stanley's description of the issue, he decided to ask Stanley a few general questions to enable Stanley to make a more informed decision about his business. Much like a doctor asks a patient about symptoms, Dr. Blair learned a great deal from listening to the client before reviewing the numbers. Dr. Blair asked his first question. "Stanley, how much is your food cost as a percentage of your monthly sales?" Stanley said, "I am sorry, but I am not certain. I am sure they are a bit high as I like to use fresh ingredients when preparing my dishes." "OK," Dr. Blair replied, "Now, let me ask about your employees. Could you tell me if they are paid hourly or salary, and what you usually spend as a percentage of your revenue?" Stanley sighed. He really could not say without looking back over his records. Finally, he told Dr. Blair, "I know I should be on top of this, but with everything to do to keep the restaurant running, I just never seem to get to the paperwork."

Dr. Blair could sense that Stanley sounded a bit defeated. He said, "It is ok, Stanley; I will help you get a handle on things. Just one last question." "How did you decide how much to charge for the food?" Stanley knew the answer to that one. He said, "I went to the local restaurants in town and saw what they charged for the same or

similar dishes.” Stanley continued, “I took their average and ensured I was priced slightly lower. I wanted to make certain that I was priced competitively.”

Dr. Blair began to think he had an idea where Stanley might be having some issues. “Stanley,” Dr. Blair said, “I would like to come by and help you understand how to study your financial records. While I cannot be certain, I believe you are having issues related to the variable costs in your business. In the restaurant business, it is essential that you control the premium costs, essentially the costs of food and hourly labor. Suppose those are not inline in line as a percentage of revenue. In that case, you could easily have experienced increased revenue but lost more money each month as your revenue grows.” Dr. Blair continued. “For example, let us say you went to one of your competitors and found that they charged \$11.99 for a certain dish. Do you believe that most of them were using the same quality of ingredients that you do?” Stanley replied, “No way. I have had some of their food. They are mostly using frozen stuff for their dishes. You can taste the difference, which is why I am getting more and more of their customers coming to me.” “Ok,” Dr. Blair replied. “I get where you are coming from.”

As they talked for a few more minutes, Dr. Blair said he would need to see the revenues and expenses for the past six months and asked Stan to have them ready. As they got off the phone, Dr. Blair said to Stan, “Hang in there. I will help you sort through this and guide you, but as a business owner, you need to understand your financial statements and the impact that costs have on your bottom line. With my help, I want you to run the analysis. This way, you will always be prepared as your business develops. The good news is that your customers love your food, and the revenues keep growing. That is no easy task. But, I am sure we will be able to identify the issues and ensure you are profitable.” Stan started to perk up. “Thanks so much, Dr. Blair.” “I appreciate your help. I guess I am getting some real-world experience about the importance of numbers and the percentage of sales in a business that you always talked about in class.” Dr. Blair smiled to himself. The school of hard knocks was always the best motivator. Stanley had hope! He must gather the financial data and evaluate the costs and the percentage of sales needed to turn his business around to have more funds on hand and show profitability. What decision should Stanley make to end the financial crisis and forgo the inevitable bankruptcy nightmare? (See Table 1 on the next page for the revenue and expense information.)

Income Statement For Prior Six Months

	Stan's Seafood								
	Income Statement (October 2013 to March 2014)								
	Oct	Nov	Dec	Jan	Feb	Mar	Total	% of Sales	
Revenue	\$37,000	\$44,000	\$51,000	\$55,000	\$58,000	\$60,000	\$305,000	100.00%	
Food Cost	\$14,125	\$17,500	\$19,200	\$22,000	\$23,600	\$25,200	\$121,625	39.88%	
Gross Margin	\$22,875	\$26,500	\$31,800	\$33,000	\$34,400	\$34,800	\$183,375	60.12%	
Expenses									
Payroll (hourly and salary)	\$12,000	\$13,000	\$17,000	\$18,000	\$18,100	\$20,400	\$98,500	32.30%	
Rent	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$36,000	11.80%	
Benefits	\$2,000	\$2,000	\$3,500	\$3,500	\$3,500	\$4,000	\$18,500	6.07%	
Electric	\$500	\$650	\$700	\$715	\$725	\$725	\$4,015	1.32%	
Leased Equipment	\$5,000	\$5,000	\$5,000	\$5,000	\$5,000	\$5,000	\$30,000	9.84%	
Phone	\$125	\$125	\$125	\$125	\$125	\$125	\$750	0.25%	
Internet	\$175	\$175	\$175	\$175	\$175	\$175	\$1,050	0.34%	
Computer system	\$300	\$300	\$300	\$300	\$300	\$300	\$1,800	0.59%	
Gas	\$700	\$800	\$900	\$950	\$975	\$1000	\$5,325	1.75%	
Uniforms	\$275	\$325	\$385	\$385	\$410	\$410	\$2,190	0.72%	
Insurance	\$1,125	\$1,125	\$1,125	\$1,125	\$1,125	\$1,125	\$6,750	2.21%	
Total Expenses	\$28,200	\$29,500	\$35,210	\$36,275	\$36,435	\$39,260	\$204,880	67.17%	
Net Income (Loss)	(\$5,325)	(\$3,000)	(\$3,410)	(\$3,275)	(\$2,035)	(\$4,460)	(\$21,505)	-7.05%	