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How to Manage Your Restaurant's Cash Flow

By Jim Laube

For many restaurant owners, one of the most perplexing and frustrating aspects of running their restaurant is the shock of getting blindsided by an unexpected shortage of cash. All too often cash can be sufficient one week only to turn into a shortfall and potential overdraft situation the next.

Having cash flow challenges can be a real distraction from productive activities and ongoing business operations. When bank balances are too low, missing a payment due date to a key supplier can threaten deliveries and services. And never underestimate the damage to your reputation and credibility when your lenders and suppliers get in the habit of not seeing their bills paid on a timely and consistent manner.

While managing cash flow can be a constant and seemingly overwhelming challenge in unprofitable restaurants, even operations that are profitable are not immune from occasional cash deficits and can unexpectedly find themselves scampering to cover a potential bank overdraft situation as well.

This article examines how you can protect your business from getting into cash flow problems in the first place and how to get a handle on what your cash situation is likely to be weeks and even months down the road. You'll learn that one of the keys to successfully managing your cash is setting up a simple yet powerful system to project your likely cash receipts and payments to alert you to potential shortages well in advance. Having such as system can alert you if a cash crunch is coming, you know about it and have time to make adjustments and avoid a crisis.

So, how do you go about keeping up with your cash flow so you can smooth out those cash flow peaks and valleys? First let's look at the dynamics of cash and how managing cash flow differs from managing income and expenses on your profit-and-loss statement.

Why Managing Your Cash Flow Is Important In Any Business

Early in my career I was the controller for a small but rapidly growing barbecue chain. Although the company was profitable, it experienced major cash flow challenges primarily because new restaurants were underfinanced and cash flow was used to make up the difference.

As a result, we "squeezed" many of our food and supply vendors who serviced our existing restaurants to continue our development of new restaurants. This was a classic case of a profitable business not having enough cash to pay all its bills because of rapid growth.

I quickly learned that there was a major difference between profitability and cash flow, and as someone responsible for making financial decisions, I needed a way to look at the business from a "cash flow" perspective.

How Cash Flow is Different From Net Income

Some operators I've worked with assumed that there was a direct relationship between net income on their profit-and-loss statement (P&L) and cash flow. They would reason that, when there's net income of $5,000, this means that they now had $5,000 more cash in the bank at the end of the month than there was at the beginning. In reality however, this is rarely the case. Net income might equal or approximate the change in cash balances between two periods but not necessarily.

First of all, a P&L (unless a cash basis of accounting is used) recognizes sales when they are "earned" regardless of when the cash from those sales is received. Although the cash from a restaurant's dining room sales are generally received either on the spot or shortly thereafter, many restaurants do catering and banquet functions, which are billed to clients and then paid some time after the event.

Often the sales associated with catering and banquet functions are recognized one month while the cash is collected the next month or even later.

Likewise, unless cash basis accounting is used (and it shouldn't), expenses are shown on the P&L when goods and services are "used" or "rendered," not when the invoices for the food, utilities or repair services are paid.

Also, restaurants like all businesses, engage in transactions and expenditures that can affect cash flow that are not reflected on the P&L. This is especially prevalent when a company is expanding or involved in making capital expenditures, like purchasing new equipment.

For example, when a new oven is purchased for $5,000 cash, your accountant would treat this as a capital expenditure and it would be classified as an "asset" on the balance sheet and depreciated over its estimated useful life, probably five to seven years. So, in the month the equipment is purchased, this $5,000 transaction would have virtually no effect on the restaurant's P&L and net income but result in a $5,000 use of cash.

Let's show the cash flow effect of just a few of these types of transactions. Below is a summarized P&L of a restaurant that earned a net income of $5,000 or 5 percent of sales for the most recent one- month period.

Income Dynamic

An Issue of “MAGNITUDE”

Sales	$ 100,000
Expenses	95,000
Net Income	$ 5,000

If all the sales during the month had been collected and only the expenses of the current month had been paid and there were no other payments or cash receipts, then it's likely that this restaurant would have about $5,000 of additional cash in the bank at the end of the month that it had at the beginning.

However, look what happens to cash flow when just a few fairly commonplace events take place during the month. First assume that there were a few catering functions during the month and $10,000 of these bills remain unpaid at month end. Also, the owner paid $5,000 for that new oven.

Now look at what happens to the cash flow for the period because of just these transactions:

P&L / Cash Flow	P&L	Adjust to Cash Flow	Cash Flow
Sales / Receipts	$ 100,000	($ 10,000)	$ 90,000
Expenses / Disbursements	95,000	5,000	100,000
Net Income / Cash Flow	$ 5,000		($ 10,000)

While the P&L may suggest to some that there should be about $5,000 more cash in the bank at the end of the period, what's really happened is that there is actually less cash because of the uncollected catering bills and the equipment purchase.

Two Different Dynamics

There are two different dynamics at work when it comes to your P&L and cash flow. Understanding a P&L is easy. It's based on "magnitude." You want more revenue or sales and fewer expenses to maximize the amount of net income or profit you earn (Figure 1):

Income Dynamic

An Issue of Magnitude

Sales	$100,000
Expenses	95,000
Net Income	5,000

Figure 1.

Sales are reflected on the P&L when they are "earned," regardless of when the cash from those sales are collected. Likewise, expenses are recorded when products are used and when services are rendered, regardless of when the invoices are paid.

The amount of cash generated or consumed by your business must be looked at in a different way. Cash flow is primarily a "timing" issue. Getting a handle on your cash situation is about understanding "when" cash flows into your business from sales and other sources and "when" cash flows out of your business as expenses and other obligations are paid.

For example, in the image below you can see that based on a simple projection of cash coming in and going out, this restaurant is looking at a potential cash shortfall of around $10,000 at the end of Month 2.

Often, the easiest way to fix an impending cash shortage is to begin by exploring ways to either collect cash quicker or delay some payments.

In this case, I'd want to know if there were ways to receive some of the cash receipts anticipated in Month 3 to be received in Month 2 instead. Also, are there any invoices scheduled for payment in Month 2 that could be rescheduled for payment in Month 3 without any negative consequences (Figure 2):

Cash Flow Dynamic
An Issue of "TIMING"

	Month 1	Month 2	Month 3
Beginning Cash	$10,000	$5,000	$(10,000)
Cash In	90,000	80,000	100,000
Cash Out	95,000	95,000	85,000
Ending Cash	$5,000	$(10,000)	$5,000

Figure 2.

If part of the $100,000 of cash receipts expected in Month 3 is due to catering or banquet sales, maybe larger deposits could be collected in advance of the events. If $5,000 of receipts could be received in Month 2 instead of Month 3, then our shortfall is down to $5,000 (Figure 3):

Cash Flow Dynamic
An Issue of "TIMING"

	Month 1	Month 2	Month 3
Beginning Cash	$10,000	$5,000	$(5,000)
Cash In	90,000	85,000 ←	95,000
Cash Out	95,000	95,000	85,000
Ending Cash	$5,000	$(5,000)	$5,000

Figure 3.

Another possibility is to delay some payments scheduled for Month 2 to Month 3. While some types of payments like payroll and sales taxes need to be paid on or before their due dates, some liabilities may offer some flexibility (Figure 4):

Cash Flow Dynamic
An Issue of "TIMING"

	Month 1	Month 2	Month 3
Beginning Cash	$10,000	$5,000	$(5,000)
Cash In	90,000	85,000	95,000
Cash Out	95,000	95,000 →	85,000
Ending Cash	$5,000	$(5,000)	$5,000

Figure 4.

If $5,000 of invoices due in Month 2 could be rescheduled to Month 3 the shortfall is gone and there is no more problem. While this is obviously a simple example, the key to being able to fix a temporary cash shortfall is knowing that you have a problem coming "ahead of time."

Cash Flow Dynamic
An Issue of "TIMING"

	Month 1	Month 2	Month 3
Beginning Cash	$10,000	$5,000	$ -0-
Cash In	90,000	85,000	95,000
Cash Out	95,000	90,000 →	90,000
Ending Cash	$5,000	$ -0-	$5,000

Creditors will not typically give you much wiggle room or sympathy if you come to them when you're desperate and already in trouble. The key is in giving yourself "time" to manage the situation and make arrangements well in advance of it becoming a crisis (Figure 5):

Figure 5.

One Key to Managing Your Cash

While working with literally hundreds of restaurants over the years, some with horrendous cash challenges, I've learned that the best thing any operator can do first is to set up a simple worksheet that gives them a way to estimate their weekly cash receipts and cash payments.

Most restaurants' cash flow can fluctuate dramatically from week to week because of the timing of payments like payroll, sales taxes and rent. By creating a weekly cash projection worksheet you'll be able to see the cash situation you're likely to face weeks or even months ahead of time. Having such a worksheet won't produce any additional cash but it can provide valuable time to take action well in advance of a potential shortage. The only thing worse than dealing with a potential cash crunch is being thrust into one that you didn't see coming that requires immediate attention and relief.

> " . . . One thing to remember when you start projecting your cash flow is that you're preparing a 'projection' -- an estimate. It's never going to be 100 percent accurate, but over time you'll find that your estimating will get better and projecting your cash flow is a whole lot better than doing nothing and essentially being in the dark. -- Jim Laube "

How to Prepare a Weekly Cash Projection

The first step in preparing weekly cash projections is to enter your beginning cash balance in the first column of the worksheet. This should be the actual book balance of your primary bank account. Next, start estimating your cash receipts from all sources by week:

CASH INFLOWS (RECEIPTS)

- Cash & Credit Card Receipts -
  - Sales
  - Plus: Sales Tax
  - Less: Paid Outs
- Loan Proceeds
- Owner/Investor Contributions
- Other -

Estimating Your Cash Inflows (Receipts):

To estimate your cash receipts, first look at your total weekly sales for the past several weeks. Notice the average and if your sales are trending any particular direction. Estimate your weekly sales going forward based on what's reasonable in light of your recent history and any seasonal factors that might affect your sales volumes going forward.

Then adjust your weekly sales estimates for the effects of sales tax, paid-outs, credit card charges and any other transactions that would affect cash coming into your business. Then estimate your cash payments by week.

After completing the cash receipts section, first estimate the amount of those payments that are "mandatory, you don't want to miss" obligations. These are liabilities that must be paid on a timely basis because of the harsh consequences that result if they are paid late.

Those mandatory obligations include payroll, payroll tax deposits, sales and liquor taxes and property tax payments. After these amounts are entered, start including the totals for vendor invoices, rent, note payments and other payables in the weekly columns in the weeks that payments are due:

CASH OUTFLOWS (PAYMENTS)

- Cost of Sales -
  - Food & Paper
  - Beer, Liquor & Wine
- Payroll -
  - Net Payroll
  - Payroll Taxes
  - Benefits - Medical, Worker's Comp
- Sales & Liquor Taxes
- Marketing
- Utilities
- G&A - Legal, Accounting
- Other Operating Expenses
- Occupancy Costs -
  - Rent
  - Property Taxes
  - Insurance
  - Equipment Leases
- Note Payments (P&I)
- Credit Card Charges
- Other -

After these other payables and obligations are entered onto the worksheet, it should become evident what your short-term cash flow situation is likely to be.

Remember, Projecting Cash Flow Is Not an Exact Science

One thing to remember when you start projecting your cash flow is that you're preparing a "projection" -- an estimate. It's never going to be 100 percent accurate, but over time you'll find that your estimating will get better and projecting your cash flow is a whole lot better than doing nothing and essentially being in the dark.

Start now preparing your cash flow projection several weeks or months into the future and I'm confident you'll quickly see what a helpful tool it is and how much you'll learn about the cash flow ebbs and flows of your business.

Some Other Cash Flow Techniques

Open a reserve bank account. Recognize that there is money that flows into your business that really isn't yours. Sales and liquor taxes fall into this category. You're mandated to collect it from your customers and then remit it to the appropriate taxing authority by a specified due date.

As mentioned earlier, these types of liabilities must be made on time or steep penalties and interest accrue.

To avoid the temptation of spending sales and liquor tax funds on other obligations, some operators deposit them directly into a separate "reserve" bank account. Each day the amount of sales and liquor tax receipts are deposited into what some refer to as a "reserve" bank account so that there is always sufficient cash available to pay them when they are due.

To do this, modify your daily sales report so that the "deposit" is broken into two amounts. One for the taxes collected on your sales of food and (if applicable) alcoholic beverages and the other for the nontax portion of the deposit.

Then each day make two deposits. The tax receipts go into the "reserve" account and the balance of the cash goes into the normal operating account.

Establishing a "reserve account" discipline can be a very effective way to ensure that you're never faced with additional penalties and fees from not paying these revenue-based taxes on time.

> “ . . . Several times in my career I've been amazed at the extent many suppliers will go to work with their customers if they're dealt with honestly and kept informed. 'No surprises' is the best policy when your vendors are helping you deal with a cash flow challenge. -- Jim Laube ”

Set favorable payment terms. In addition to serving dining room customers, many restaurants today earn a large portion of their sales providing catering and banquet services. This can provide cash flow opportunities or additional challenges depending on how a restaurant's payment and credit policies are structured.

Some of our members on RestaurantOwner.com have reported great success using the following payment terms on catering and other special functions. They require a 50 percent deposit when the party or banquet is booked with full payment due five business days prior to the day of the event. There are several advantages for having such a payment policy:

- **Positive cash flow.** With the 50 percent deposit, the restaurant has a sufficient amount of working capital to purchase the food and other supplies for each event. Also, requiring the balance of each function to be paid in full prior to the day of the event means cash in the bank and no receivables.
- **No collection activities or bad debts.** In addition to positive cash flow, no trade receivables from catering and banquet activities means the restaurant doesn't have to keep track of unpaid invoices and contact deadbeat customers. Not having to write off uncollectible accounts is also a major

benefit.

- **Makes the customer, not the restaurant at risk for no-shows.** One of our members reported a situation in which a banquet customer chose their most expensive buffet and had 10 no-shows out of a 45-person guarantee. Because of the contract and the upfront payment, the restaurant was in control when the customer tried to renegotiate the final bill. The restaurant explained that food for 45 guests had been prepared and offered the leftovers to the client. Everyone left happy.

No Matter How Tempting, DON'T DO THIS!

Regardless of how severe your cash flow problems become, don't be tempted to temporarily relieve the situation by diverting money due to certain taxing authorities. Just because they aren't hounding you (today) for their money doesn't mean you're not on their radar screen.

We mentioned sales and liquor tax payments but I'd like to also refer specifically to payroll (941) taxes. Payroll taxes include FICA and withholding tax withheld from your employees' pay checks that your business has a fiduciary responsible to pay a certain number of days after each payroll.

Even though the IRS won't be calling you every few weeks to make sure these taxes have been paid, have no doubt that they will be following up very diligently to make sure the taxes were not only paid but paid on a timely basis.

One reason it's so important to make sure payroll tax deposits are made promptly is that, like sales and liquor taxes, this money is not yours. It's your employees' money, that they earned, that you withheld from their checks.

The IRS will do whatever it takes (including confiscating your personal assets, house, first-born, etc.) to recover unpaid payroll tax deposits. Also, the penalties and interest tacked on for making these payments late are very, very stiff. (Alright, I did exaggerate a bit on the "first-born" part.)

One possibility when cash is tight: If you have any wiggle room in terms of payment it's generally with your suppliers. Unless you've been a jerk customer, they want to keep your business. The key is letting them know of a potential cash situation well ahead of time. Don't wait until you're in a crisis situation.

If your suppliers agree to work with you, keep them informed, don't make them have to call you. Like anyone, vendors don't like being left in the dark, and that usually means being lied to, not having their phone calls returned and listening to lame excuses. If you say you're going to do something, do it. Credibility is everything in these types of situations and if you lose credibility, you'll lose your credit-worthiness too.

Several times in my career I've been amazed at the extent many suppliers will go to work with their customers if they're dealt with honestly and kept informed. "No surprises" is the best policy when your vendors are helping you deal with a cash flow challenge.

Raise Your Cash Flow I.Q.

Any business can have cash flow hurdles to overcome, even profitable ones. As we've discussed, it's much easier handling cash flow issues when you see them coming, before you're scrambling to make payroll. Raising your cash flow IQ by putting in place a simple but enlightening cash flow projection may be all you need to help you avert a cash flow catastrophe and keep you on top of your ever- changing cash flow picture.