Illustration by Keith Ibsen

By Jay Goldstein

On a Shoestring

Creating a Workable Concept on a Tight Budget

As the old saw goes, it takes money to make money. For better or worse, this is true to some extent; however, if only wealthy people could start businesses, there would be very few entrepreneurs.

This is particularly so in the restaurant business, since institutional financing is often scarce for startups and money is typically raised from personal resources. Everyday hundreds of people look to open their own restaurant and build a successful, long-term business. One of the greatest challenges facing these would-be restaurateurs is the funding of their new ventures. Understanding that there are a number of ways to go about sourcing and attracting the required financing, the lion's share of these new owners will wind up putting together a patchwork financing package that will include money from family, friends, business associates, and possibly the Small Business Administration (SBA).

Let's put a face on this situation: A guy or gal takes early retirement from a corporate gig to start a local bar and grill. He or she may have some equity in the house, and a savings account from which to draw. Uncle Bob, Mom and Dad, and a few friends want to invest as well. The owner knows it will take several months to begin generating positive cash flow, so he needs something set aside to tide him and his family over until the business gains momentum. This is not uncommon.

Be aware that undercapitalization is one of the leading causes of restaurant failure. You need to pad your budget to allow for contingencies. That said, even Donald Trump's resources are finite, and the difference between success and just another failed attempt may be resourcefulness — an absolutely indispensable trait of winning entrepreneurs. This article will explore ways to open your new restaurant on a "shoestring" budget while still producing the desired result. We'll look at methods to stretch your capital budget dollars and find "hidden" sources of funding.

On a 'Shoestring,' Planning Is Even More Crucial

Cost overruns are almost a cliché among startup businesses. The $1 million project becomes $1.25 million.

Oh, well (sigh), if the problem can be solved by shifting money out of another business or having a heart-to-heart with the local banker, it doesn't have to be a disaster. But if you're extended to the hilt from the beginning, it can be a bona fide crisis. The moral of the story is your business and financial plans must be well-thought-out and very conservative.

You need to know what it is that you want to do and you should always start with a plan. It has been said that if you don't know where you are going then any road will take you there. On this journey you will want to not only know where you are going, but outline how you intend to get there.

You are, in essence, creating your own road map to success. As you build your road map it is imperative that you know the money requirements (how much fuel you'll need to make the trip) before you begin to raise the funds. The financial analysis, which includes the capital budget, is an integral part of the business plan process and one that will guide your activities. The business plan has always been and always will be a critical piece to the success of any business. A shoestring budget makes this plan that much more important as there is little to no room for error. For more information on constructing your business plan, see "Mapping Your New Restaurant's Journey," in the May 2005 issue of *Restaurant Startup & Growth*, and "The Heartbeat of Your Business Plan" in the June 2005 issue. Study these articles.

Stick to Your Core Elements

One of the greatest enemies of all startup businesses is unnecessary overhead and trying to be too much, too soon. Fancy furniture, a catering truck, and expensive décor make you feel like a big shot, but they may have very little to do with the success of the business. Dreaming big is admirable, but you need to keep your goals in check with your resources. In your mind's eye you see a breakfast day part at your new deli; however, your marketing and site selection tell you it is the 11 a.m. to 2 p.m. lunch crowd that will get your business off the ground.

Start by identifying the "core elements" of the concept. By doing so you will have a very clear idea of what is a "need to have" versus a "nice to have." If you waste any of your time or money on what is not absolutely critical you could run out of both before you get where you are going. You can build your business in stages over time once the "core" of your concept has been opened. When building the rest in stages over time you can expand to a full concept as you create cash flow from operations. As you open other parts of the business (lunch, takeout, banquets, catering, late-night entertainment, etc.) to drive the top line you can add the necessary equipment as you grow and need greater capacity, or upgrade equipment as you go.

Opportunities arise unexpectedly down the road. A tavern owner in Raleigh, North Carolina, learned the quick-service restaurant franchise owner next door did not extend his lease. After three years and a healthy following, he is expanding into that space. If he had tried to support that many square feet from the get-go, his overhead likely would have overtaxed his cash flow.

Finding an Affordable Site

Don't rush to purchase or rent the first decent site you find. If you do your homework, you may find deals that can save you tens of thousands of dollars a year. Look for opportunities in your marketplace. This may take some time, but in the end you will be intimately familiar with your market and the competition. You will look for closed restaurants, restaurants for sale, and equipment auctions. A real estate or leasing agent is invaluable in this regard since they can be on the lookout for ideal commercial properties, and know the going rates.

A property that housed a restaurant can present an excellent opportunity. (Just be sure to analyze why the seller is getting out of the business or why the operation closed. You might find that the location was poorly suited for a restaurant for some reason.) One big upside of these locations is that they already have most of the required infrastructure, such as vent hoods, mechanical, electrical, plumbing, grease traps, signage, wiring for point-of-sale systems, phone lines, credit card processing, and computers. They have already been through the process of acquiring the necessary licenses, permits and zoning approvals.

Another upside is that, in most cases, you will find that you will have a highly motivated landlord. Converting a restaurant to retail or general office space can be expensive and might deter other businesses from taking over the lease. They may be eager to have another restaurant tenant take the space as quickly as possible.

One caveat: Purchasing or leasing a poor site to save money can be disastrously false economy. The traffic you might gain by choosing an "A" or "B" site might more than make up for the extra thousand-dollars-a-month expense of the better site. For more information, see "On the Money: How to Find the Right Location for Your Next Restaurant," *RS&G*, October 2005.

Restaurant brokers provide a tremendous service; however, the seller pays a respectable fee for their efforts. Some consultants believe that if you find the property on your own, you may eliminate brokerage fees, thereby making yourself that much more attractive to the seller or landlord. The rationale is that it should create a bit more room for better lease terms and incentives because they did not bear the expense of a broker or leasing agent. For the first-time buyer, however, shopping for a restaurant through a broker can reduce some of the risk involved in the transaction. A reputable broker can help you find the right business, based on your budget and objectives, and can assist with the transaction. For example, they often will arrange for an "escrow" attorney to prepare documents for your and the seller's attorneys and hold funds until the transaction is completed.

When negotiating the lease there are several items that you will want to address. The key opportunities are as follows:

No rent for a specified period. This will give you time to get into the facility and do whatever work is necessary before opening. If you can open before your rent actually begins you are off to a significant advantage in creating cash flow. You may be able to take occupancy of a space 60-120 days before your first rent payment is due. If you can open within 30-45 days you have the benefit of operating rent-free for a period of time.

Graduated rent is where you start with a lower monthly rent and build into the final negotiated rent amount. If you have agreed on a rent factor of $6,000 per month, you may be able to pay $3,000 for the first three months, $4,500 for the next three months, and then $6,000 from month seven forward. In this example you would save $13,500 over the first six months of the lease.

Tenant improvement money is sometimes available and is an allowance negotiated with the landlord for the build-out or remodeling of a rented space. These allowances are usually calculated on a per-square-foot basis. For example, if you have leased 3,000 square feet of space and can agree on a $10-per-foot allowance you then have $30,000 for your renovation of the space. This can be a tremendous savings in your capital budget.

Negotiate a cap on CAM charges. CAM is the "common area maintenance" fee charged by most landlords. This is to help them offset the cost of operating the property or the retail center. This fee includes things like the center's landscaping costs, parking lot maintenance and repair, parking lot lighting maintenance and repair, associated management fees, and security expenses. It is wise to agree on an annual cap for CAM fee increases. It is customary to be able to cap these fees at an annual increase of 4 percent to 5 percent.

Include in the lease existing equipment that was left behind by the previous tenant. If you are able to include items like kitchen equipment, POS systems or computers, furniture, fixtures, bar equipment or small wares, you can come out way ahead of the game. Anything that can be included in the lease means that you do not have to go out and purchase or lease those items, thereby lowering your initial cash outlay.

All of the above are subject to the supply and demand on commercial lease space in your particular market. Some areas will be easier to negotiate than others, but you should be aware of what you can gain in the lease negotiation process. (For more information, see "Avoid a Leasing Horror Story," *RS&G*, June 2004.)

Saving Money on Furniture, Fixtures, Equipment and Initial Inventory

Auctions are a terrific place to purchase perfectly good furniture and fixtures. You can find these auctions via the Internet, newspaper advertisements, or by asking around. If you do a Google® search for auctions you will come up with a multitude of options. Your local newspaper will have these auctions listed from time to time so you will need to scour the papers regularly to find them. You can also ask other restaurateurs where they have found these auctions. They can be most helpful and they may even have some things to sell. If you can purchase an entire package you may come up with the best pricing possible. If there are items in the package that you cannot use you can then turn around and sell them to someone else or to an auction house.

Used equipment is another source of potential savings, but with some strong caveats. As many operators have found, purchasing used equipment can be false economy, when they find out several months into the business they have had to replace used equipment, due to unreliability and/or lack of parts or service. If you buy used, always inquire about available warranties and service contracts.

A Little Help From Your Vendors

Special financing. One source of funding that is rarely discussed is called "vendor participation." You can take advantage of this source in a number of different ways. Depending on the food or beverage vendor, their product line, and the potential sales volume through your restaurant and bar, you may be able to negotiate an upfront dollar amount, an allowance over time, discounted pricing, free equipment and maintenance as long as you use their product, displays, cabinets, shelves, stands, refrigerators, freezers, or beverage dispensers for sodas, soft drinks, coffee and tea. You will need to analyze what you bring to the table for them and how you add value as a client.

Remember that you are entering a two-way relationship, and that each party will have an interest in serving their respective needs. This is not an exercise to see how much you can get from the vendors, but rather an effort to have them help you maximize your value to them as a client. In this manner you will build a long-term relationship of mutual respect and trust. Another way to take advantage of funding is to negotiate favorable payment terms. If you can agree on 30 days net versus 10 days net you will have the use of that money for a full 20 days longer. Sometimes there will be a trade-off in pricing on products, but you can weigh the advantages of lower prices against the use of funds for 20 days and see which is of greater benefit to your business situation.

Menu and marketing support. Menu printing can be paid by vendors and many times they are eager to do so. This is most prevalent with beverage companies. How many times have you gone into a restaurant or bar and found the logo of a particular company on the menu. If you open the bar menu you will probably see a brand of tequila, rum or vodka in some specialty drinks. You will also find all kinds of beer logos on menus. The beverage groups have paid to have their logo on that menu by picking up the cost of the menu printing. You will see Coke®, Pepsi®, Minute Maid®, Dr Pepper®, Tabasco®, Certified Angus Beef®, Blue Bell® Ice Cream, and many more names and logos on the menus at many of your favorite eateries. Now you know why they are there. When making decisions on who and what you will allow on your menus, always remember what it is that you want to convey to your guests. It would be easy to take money from everyone, but it is much wiser to ensure that the logos that show up on your menu reinforce your brand and your concept. Be as strategic as possible in picking your partner vendors.

Marketing dollars are also available from vendors in other ways. They will help you with the cost of your grand opening party, initial public relations campaigns, direct mail pieces, and promotions to attract more business. In most cases you will need to commit to purchase their products over a specified period to receive this funding, and occasionally they will build the costs back into pricing. Be sure to ask how their support potentially affects your pricing structure with them. If you think it is too much you can try to get better terms or simply not take their marketing dollars.

Research and development. Market research and menu development can be done on a shoestring by using the services of your chosen prime vendor, or by contacting your local culinary schools and using the talents of some of their students. You will find that your prime vendor has access to culinary talent and some of them employ full-time executive chefs. They will work to develop menu items that use the items they want you to buy, but this can be a very valuable service for you. If you already have an idea of what you want your menu to be it is a good idea to go the avenue of a culinary school. These students understand that they not only need to create recipes and dishes that taste good and are appealing in presentation, they also know that you need to be able to mass produce the items and do so at a reasonable cost of goods and labor cost. They get the real-world aspects of putting together menu items. This may sound a bit funny, but it is amazing what you can pick up from the Food Channel in menu ideas and recipes. There is also a plethora of recipes on the Internet. All you have to do is keep your eyes and ears open to discover things that will work for you.

Do not underestimate what it will cost to open a restaurant. Moreover, don't underestimate what it will take to carry a restaurant from its opening day to its profitable point.

Shop the "big boxes" for staple items. If choosing a prime vendor is not the right approach for you then it might make sense to look at the "big box" discounters for some of your basic supplies. There is a large segment of the restaurant community that purchases their raw ingredients, paper goods, cleaning supplies, tablewares, kitchen supplies, and other necessary items from Sam's Club, Costco®, Restaurant Depot, and a few others. Most of these outlets require a membership to shop there, and in some cases the membership fee is free. Restaurant Depot requires only that you make an application and produce your business license to become a member.

You don't need it all. Above all, manage salespeople and representatives. You don't need everything they sell. In the pressure cooker environment of opening a new restaurant you must stay on alert with sales representatives. It is up to you to manage the number and amount of products that you purchase. Ensure that you are only buying what is totally necessary to get the restaurant open and operating and not one thing more. You do not need to have your money tied up in inventory sitting on a shelf.

Trade-outs

You have a valuable barter tool available to you. Trade-outs with other businesses can get a lot of what you need. You can get services in exchange for food and beverage where your cost is only about 30 percent. As an example, if you pay for your printing you may be able to do a trade-out for a portion of the cost. If the total job is $500 you can offer $200 in cash and $300 in gift certificates. If the offer is accepted you will pay about $290 for the job. This approach can be taken with contractors, service providers, and professional services (accounting, legal, etc.). For example, some attorneys or CPAs will provide services in exchange for "comp" meals to wine-and-dine other clients. If the service provider believes your operation will provide a long-term source of business, he or she will want to cement that relationship by extending short-term payment arrangements to help you get on your way.

Do It Yourself

Do some of your own construction and renovation if you have the time and the talent. Painting covers a lot of ills in a converted space and is relatively easy for you to do. Do as much as you can. You can refinish furniture, hang artifacts, install restroom fixtures, hang signs, build shelves, and many other things.

Preopening marketing is another chance to do it yourself. By contacting and creating relationships with local chambers of commerce, civic clubs, community organizations, businesses, schools, churches and athletic teams you will have a powerful connection with your target customers. You can deliver samples of your food, cater small events and meetings, contribute food and beverage for their events, and sponsor teams or events. Again, it is important for you to know your target customer, their location, their activities, and what is important to them. Be sure you aim your efforts at them to maximize your investment.

It is advisable to seek credible legal counsel as you enter your new business; however, it is also possible to manage these costs as well. Legal costs can be considerable and you need to know some of the alternatives available to you. In most states you can form and register your business entity (secretary of state), trademark the business name (U.S. patent and trademark office), obtain an employment identification number (Internal Revenue Service), and register a fictitious business name (county register of deeds) on various federal, state, and county government Web sites, which often provide detailed information on the processes involved. If you choose to do these things yourself you still might have your attorney review your work product to ensure that you have not overlooked crucial points. The expense of the review may be a fraction of the cost you would normally incur to have them do all of the work. More complex matters, such as drafting and reviewing leases, purchase agreements, and operating agreements are best left to a pro. Remember the old adage: The person who represents himself in his own legal matters has a fool for a client and an idiot for an attorney.

Don't Forget the 90-Day Countdown

The biggest cost overruns often occur 90 days from opening. For example, if you don't schedule the health inspection soon enough, any retrofits might have to be done last minute, at a premium. By using a 90-day countdown to opening you have an excellent tool to help you manage the preopening process. You will be able to plan and execute all that is necessary to get to a successful opening. This is important because without this tool there is a tendency to forget critical steps, creating extra expenses and wasting time. When you stay ahead of the curve you will be more in control and encounter fewer costly surprises.

Write your job descriptions and training manuals to be effective in your opening process. It is at least 10 times as costly to open with an unprepared staff, as it is to open with a well-trained, well-equipped, well-prepared crew. The money you invest in good training will be returned many times over in a happy, stable staff that delivers a consistently dependable great customer experience.

Failing to Plan is Planning to Fail

Hopefully, you'll have gleaned some useful information on saving money in the opening and expansion process. Still, do not underestimate what it will cost to open a restaurant. Moreover, don't underestimate what it will take to carry a restaurant from its opening day to its profitable point. Create a financial plan and budget, and allow for unexpected costs. Combined with frugality and a realistic view of the restaurant, you might find an unexpected but happy surprise: You came in under budget. **RS&G**

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