



By Mark Kelnhofer, CFBE, CTA, MBA

Understanding Your True Menu Item Costs

If there was ever a time to increase the accuracy of your recipe costing, it is now during this global pandemic. With states and cities imposing capacity requirements on many restaurant operators, it has pushed recipe costing and cost controls in the forefront of everyone's mind. For years, I have been attempting to push a higher level of accuracy by identifying the true costs to produce menu items (ingredients, direct labor, and overhead). With decreased volumes, many operators do not understand the actual impact that overhead has on menu items. Fixed overhead, with the decreased volumes, increases menu item costs. The only way that you can truly plan for profitability is the identify with a higher level of accuracy your true costs.

The three components of cost. In today's restaurant industry, cost identification is difficult and because of that, in many cases, recipe costing is largely ignored or partially done. The recipe documentation is a lot more complicated than most would think. It not only includes the ingredients, but much more details to include the quantity, unit of measures, utensils, food safety, equipment, tools, prep time, photos, and other aspects. All these details are to establish performance standards and expectations and when documented correctly, we can identify and manage all three components of cost: ingredients, direct labor and overhead. This is so critical to understand all three of these components when were are experiencing decreased volumes and an uncertain future. Incomplete recipe documentation always translates to loose cost controls and understated costs.

Requirements to Calculate Labor and Overhead Costs. In order to calculate labor and overhead costs on any recipe, it is required to have a time standard or prep time determined for every recipe. This means that all recipes and processes need to be calculated no matter how simple the process is. The documentation is where most

TOTAL COST

INGREDIENTS	DIRECT LABOR	OVERHEAD	
VARIABLE	VARIABLE	VARIABLE	FIXED

of the challenges are. In so many cases, recipes are partially documented or not documented at all. Add to that, it is very rare that prep times exist on recipes as well. The prep time is your expectation on how long the recipe should take in labor to execute it. Once you have that, direct labor on the recipes can be calculated (labor hours times labor rate per hour). Overhead also can be calculated by recipe once you have identified the labor standard (labor hours times overhead rate per hour). Overhead rates are estimates so that every time a recipe is produced or sold, we account for variable and fixed overhead expenses on the menu item. This is a very common practice to determine a total cost for the product.

Variable vs. Fixed Expenses. Operators do need to understand the difference between a variable cost and a fixed cost. Variable costs on a per unit based do not change, but do change as volume changes. As an example, a purchased hamburger bun may be \$0.12 each. As soon as a guest orders a second hamburger, the total costs related to the hamburger bun is now \$0.24. The same with labor, the higher the volume the greater the total costs. Variable costs are costs that we can manage, control, and if we need to, possibly change (i.e. alternative ingredients, labor improvements, possible make buy decisions, etc.). Fixed costs we do not have control of but are costs that we can expect to happen regardless of volume (i.e. depreciation, rent, some utilities, etc.). In times where volumes are decreased, the fixed cost per menu item automatically increases. This is why it is so critical to have a total cost picture versus only ingredients.

Impact of Fixed Overhead on Menu Items. Fixed expenses, as stated above, are amounts we pay every period regardless of the volumes we experience. However, costs per menu item can change significantly. In the circumstance that we have currently, decreased volumes, the fixed overhead costs have less volume (labor hours) to spread the costs over. This translated to higher per menu item costs. In order to methodically respond to these pressures, it is paramount that a total cost be calculated for every menu item. Price increases may not always be the answer and you must consider other options to reduce costs as well.

Know When To Engage a Consultant. Total recipe costing has some complexity. If you are not comfortable or knowledgeable enough to tackle this task, get some help! It is ingrained in the entrepreneurial mindset, to attempt to do everything internally as much as possible. In this case, costing and planning for profitability is incredibly critical for the operation to survive the pandemic and become profitable in the long term. Don't be afraid to ask for help to gain a higher level of understanding of your cost structure. It is that important!

Mark Kelnhofer, CFBE, CTA, MBA, is the President and CEO of Return On Ingredients LLC and has nearly three decades in management accounting experience including 18 years restaurant and foodservice industry. Additionally, he is also adjunct faculty at The Ohio State University in Columbus, Ohio for their Hospitality Management program and Georgetown University, in Washington, DC, for their Global Hospitality Leadership (GLH) masters program. He has published several books, numerous articles, and a periodical publication entitled [FB&L] Food, Beverage, and Labor Cost Control Quarterly. He can be reached at (614) 558-2239 and Mark@ReturnOnIngredients.com.



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