

Ep #39: The Top 5 Financial Mistakes of New Restaurant Owners



Full Episode Transcript

With Your Hosts

Patrick Totah and Andy Mirabell

[Restaurant Deal Making EXPOSED!](#) with Patrick and Andy

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Welcome to *Restaurant Deal Making EXPOSED!*, the only show that equips you with everything you need to know about restaurant transactions. In this show, we tell you all about how to make the sale or purchase of your restaurant not just possible, but successful. Now, here are your hosts, ex-restaurateurs, and seasoned brokers, Patrick Totah and Andy Mirabell.

Patrick Totah: Hey, everyone. We are back with *Restaurant Deal Making EXPOSED!* I am with Andy. This is our 39th episode, and we are going to talk about the top five financial mistakes of a new restaurant owner.

Choosing to buy a restaurant or bar should be no small decision. People often glamorize owning a restaurant or a bar and can hugely underestimate the layers of commitments that come along with ownership. Restaurants in particular take a large amount of funds to open and to operate day to day. Profit margins are most often small; thus, a small shift in sales trends can have huge impacts on cash flow and the ability to operate.

Today, we will list the top five mistakes that we feel new restaurant owners make.

Andy Mirabell: There it is.

Patrick: Andy, welcome.

Andy: Thank you so much, Patrick. I want to remind everyone, although we're restaurant brokers now, we are ex-restaurateurs. We have run and worked with companies that have opened and closed multiple restaurants, you know, locations and been part of chains and so on. We have failed. We've had failure and successes. There is a strong learning curve with opening your own business. This is not us chastising anyone about mistakes because we probably have done the majority of these and learned the hard way. Right, Patrick?

Patrick: Oh yeah.

Andy: All right.

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Patrick: I will tell you about my mistakes because they're the best learning experiences of my life.

Andy: Exactly. So I'm not going to joke and say I've made no mistakes, but we get better from losing at times, and we get better from mistakes. So as long as we learn from them.

Running a restaurant, it was amazing. I loved it. I really did. I loved the energy of it. I loved the pace of it. I loved the people I worked with. I loved the people we served. So there were so many positive things, and I highly encourage if it's something you're interested in, pursue it.

But please work for others first, learn from others first. I don't mean just learn from a chef or an operational GM or something. I mean, learn the back end, learn from a good bookkeeper, all the nuances, because it's really going to set you up for success. And if you don't, there could be some really rude awakenings coming once you take your first venture. So let's get, let's just dive into the list here. What do we put as our first item?

Patrick: Yeah, I think one of the most important things is not underestimating the startup capital that you need and the working capital that you need. Again, I speak from experience.

When I bought my first restaurant, me and my cousin/partner, we put all of our money into it. And when we started up, we had a little leftover after we purchased the restaurant, bought our inventory. And what ended up happening, because we had a pretty strong catering business, is that we were cash poor, you know, throughout like a big part of the month. Our cash flow was so low and so we had to wait for all of our checks to come in. And it would have been nice to have a nice buffer in the bank to cover payroll, get your cost of goods.

And so I think one of the bigger things that, you know, people go into restaurants is they think about, oh, I just need X amount of dollars to make this purchase.

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But they don't think about the security deposit. They don't think about first month's rent. They don't think about the expenses for like escrow and all the, you know, all the other expenses that you can possibly have along the way. And then on top of that, you know, I tell everybody you need at least three to six months of working capital to feel good.

Andy: Minimum. Minimum. Yeah, absolutely. Every time, if we price process payroll 26 times a week, I mean a year, sorry, it's a staggering number if you don't have income coming in. So, especially before you open, we took two full weeks of full-time training before we opened, and it was a staggering amount. We had to go back to our personal accounts and replenish our operating account before we opened.

People don't predict for delays either, okay? I was, for my restaurant in San Francisco, I was forced to open because we were running out of money, and the ABC license transfer got delayed by multiple weeks. And so we decided to open with a BYOB sort of situation and just try to get open. We got a slap on the wrist for doing that, but just in time before the ABC said, Okay, your license is live. But we couldn't hold off on operating anymore. We needed some level of income.

So I think there's some underestimating in how much you really need as that kind of nest egg to protect you if things don't stay on track, stay on schedule, or other, or sales aren't where they need to be, right?

Patrick: Yeah. I mean, otherwise you're robbing Peter to pay Paul, you know? And it's like, you got to make sure you pay your sales tax to the sales tax authority, and you got to make sure you have your next payroll, because guess what? If you miss a paycheck, your employees are going to start to get wind of that and they're going to quit. These are very important things that we're talking about, and that's why I put it as number one.

Andy: I think also what we're bringing up, a lot of that is, you know, general information as to keep enough money in your operating account, but a lot of it was pre-opening. I'll be honest, as years go on, went on, as a restaurant owner, there's good years and bad years. And so sometimes we need money, right?

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Where do we go look for money when we need it, you know, just because it's been an off year, seasonality is different than the previous year, and you didn't predict for it? Where do we go get money as a restaurant owner?

Patrick: Yeah, I mean, there are good money and bad money, right? I mean, and there is like line of credits that you can get from like a Wells Fargo under your LLC. In fact, I got a Wells Fargo line of credit that was unsecured and we used to use that when our, you know, as I started to learn the game a little bit, I was like, oh, I could use this to kind of cover my costs for those 10 to 15 days that we're cash poor and then all my money comes in from catering and then I can, you know, so it was this constant back and forth. But there are also lots of bad money out there. And I see it a lot with these POS lines of credit where, you know, basically they give you, you know, fifty thousand dollars and then they pull that money back out on a daily basis from your like credit cards.

Andy: From your credit, the credit cards your customers are paying for their meal. They suck the money out immediately, right?

Patrick: I see this all the time, and I'm like, oh my God, this has to be a kiss of death because basically that's lowering your cash flow every single day. And as we know in the restaurant industry, if you take away 10, 20, 30% of your cash flow.

Andy: What's left? You're already paying credit card processing fees. So Dan emailed us something. You want to share kind of what his, his take on, Dan Engel, we keep referring to him. Now he's going to have to buy his dinner, not just lunch.

Patrick: Yeah, what did Dan say here? He says, "Borrowing money from your POS for working capital with no plan on how to make your business profitable, this leads to a quick decline in cash flow and spells doom for most restaurants. If the POS is deducting 10% of your credit card deposits to pay the loan, that means you have to have 10% profits at the bottom line just to keep up with your loan payments." I could not agree with this more, and I see it all the time and I'm like, oh, no wonder this restaurant didn't make it.

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Andy: We quoted that from Dan Engel, Engel Accounting. We reached out to him and said, What is one of the largest mistakes you're seeing restaurateurs do today? And that was his big and bold warning.

I agree with you, just to touch on it briefly. In times of need, I built up my line of credit with my Wells Fargo, I did with my businesses. We paid all of our smaller vendors with my business credit card. I built up my credit with them and within a few years, I was able to have a six-figure emergency line of credit when I needed it for a purchase, a repair, or so on. It was helpful beyond belief, right?

We also used programs like iDine. Now, that can be a double-edged sword. You are paying X amount of dollars per cover in your restaurant to a program that's going to lend you money and you're paying them back every time they send someone in your, put someone in your seat, X amount of dollars. They also do a lot of advertising for you and so on, but they are sending you customers and you only pay it back once the customers are there. But it is expensive. So it can be a false illusion. Oh, my seats are full tonight. I got to, I turned my whole restaurant one and a half times, but it was expensive to do that. So be careful. All right.

Patrick: All right, Andy, what's the number two?

Andy: Mispricing the menu. There's a lot of restaurateurs that do that kind of by the, by the seat of their pants.

Patrick: Oh yeah.

Andy: I did it. I struggled for so long when costs in San Francisco went so high with mandated health care, labor kept going up, at times, the highest in the country. And I just remember going, but I can't charge my customers ten dollars for a side of french fries. I just can't. I was, it was a hard no.

But guess what? That's a good margin product. I needed to raise my prices. That's just an example I'm using, but it's okay to feel like you're looking through the lens of your customer and saying, I don't want them to think we're too expensive.

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But the reality of keeping your doors open and paying your bills means that you need to use real math to price out your cost of goods and know how to price menu items by the amount of ounces of fish you put on the plate, by the amount of veggies that you're using from your seasonal veggie producer, whatever it is. You need to be smart about it. And you might want to resource an accountant to help you do it if you don't know how to do it, right?

Patrick: Yeah, I would argue that a large percentage of restaurant owners do not price out their menu. I think it's like 70, 80% plus. Like, I think most people either take over a restaurant and start as that as like a starting point and then just maybe raise it every now and then, like from the hip, like, oh, I think I'll go up 7% or something like that, right? Or like they look at other menus, and they're getting the prices from that.

I would argue that, and I tell this to people all the time, like let's say you were to raise your prices, and because a lot of people, I think, are really, really scared to raise their prices because they think that they're going to alienate their customers.

But what if you actually raised your prices and you do lose some customers, and you still make more money? Because if you're pricing things correctly and you lose a couple percent, the difference that you're making is still more and you actually may have, you know, maybe you need less staff members because you're, you know, I mean, I'm just making an argument here that, you know, losing customers doesn't have to be a bad thing if you're actually making more in the long run.

Andy: No, I totally get what you're saying, and I agree with it. This is a big topic we've had on. We talked about it in our recent quick service restaurant episode, but commissions for third-party delivery apps, okay? This sector of the restaurant world has absolutely exploded since 2020, right? I mean, just bananas, but so has the, so have the rates that these third-party apps charge the restaurants to pick up their food, you know, advertise their menus, pick up their food, and get it to the customer.

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So we've seen the commissions for these third-party apps fall in different places on P&Ls. And you can't hide them. You're paying them. They're 15, 20. They, I've heard 30% on some of these. It's a huge amount. And it really can make certain restaurant dishes and certain restaurants, they're not making money on this stuff. Am I wrong?

Patrick: I think some people have like taken it upon themselves to learn how to make money on it. And I think a large percent of restaurants are like, again, just being taken on a ride, and they get that check at the end of the month for their total DoorDash, and they're like, oh, three thousand dollars, right?

Andy: Yeah. How much work did we put in to get the, send out the twenty thousand dollars worth of food?

Patrick: How much of that big check is actually profit? Like, you know, is it 5%? Is it 3%? Is it, you know, I do wonder, and I think it's a major, major problem. And I think people really need to understand how much they're making. And again, if you're costing out your menu and then also on top of that, taking commission into consideration, then you truly know how much you're making on this item and that item, right?

Andy: Yeah. And I think our friend from World Wrapps, you know, he really pointed it out. He's like, this is a cost we are okay with. It blew my mind when he stated that the amount they pay for third-party delivery apps trumps the rent they pay at the location. I had not heard that stat. We always think rent, labor, those are the two highest things we deal with. I'm shocked to hear that.

Patrick: And he's in a really high-end mall. So his rent is not cheap.

Andy: It's expensive. Yeah, exactly. So anyways, just know what you're getting into. These things can be very beneficial, especially to QSR restaurants and such, but know what you're getting into and know what, how the cost breaks down. Know where to put it on your, your P&L. Talk to your bookkeeper about that.

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Patrick: The other thing that I want to point out is like throughout the like year or throughout the years, there are sometimes like things like remember last year when we had that whole egg situation where, you know, eggs used to be like thirty dollars a case or 20, I've seen them as low as twenty dollars a case and they went up to like 150 or 160, 200 a case, right? And I've seen businesses make no adjustments for that.

So basically, during that three to six-month period, and let's just say you're a diner or a breakfast spot and you've made no adjustment for, you know, this price of your main ingredient going up, like you've just taken a pay cut for that period of time, basically.

Andy: Huge, because of that one ingredient. It may be an important ingredient for a breakfast or brunch place, but and you use a lot of it, you got to make adjustments. I'm lucky because I have chickens at home, so Honey and Onyx are still producing eggs.

But anyways, account for all costs. So as a business owner, a restaurant owner, you need to understand your profit and loss. You need to be very clear on it and see the minute changes month to month and know how to adjust or why those changes are happening.

Did you not catch something on a price increase on an invoice? Did you overorder, underorder, whatever it may be? Know it. Understand what your controllable costs are and be always aware of what your uncontrollable are, your fixed costs.

And I think we see so many different kinds of accounting and P&Ls from our clients. And it's fine to have differences from business to businesses, but there's a lot of things when you're getting into ownership of a new restaurant that you don't think about.

Maybe you didn't think that you're going to be paying thousands of dollars a month to rent your dishwasher machine and your bar dishwasher machine. Maybe you didn't think of that. Maybe you didn't budget for minimum 1% of sales

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to go to repairs each month. Because I promise you, as the restaurant gets older, you're going to have some big ten thousand, twenty thousand dollar repairs that you're just, you just didn't prepare for or didn't budget for. Right?

Patrick: Yeah, I don't think a lot of people are budgeting for anything. The other thing I want to just go back a second is vendors. I can't tell you how many times I would look at my vendor list and on items that I knew I was quoted a different price and that was all of a sudden more expensive. I would have to look at my invoices every single time that they came in, I would go and scan through it and that could be a job in itself.

And I could tell you so many times where like I had to call my like, you know, my guy there, and, hey, this price is incorrect. Oh yeah, let's get that worked out for you. And you know, if you don't pay attention to your invoices that are coming in daily, you are getting overpriced. And that's the start of the whole thing right there.

Andy: It's okay. And also listen, I'm not very tech savvy. I'll admit it. I'm a guy who writes things on post-its and so on. And like you just said, Patrick, I would make photocopies of all of my invoices, put it in my box in my office, and at the end of the month, I would go through all of my photocopies and make sure that those prices stayed the same on my inventory sheet each month.

Now, as I got more complacent, older, the place was running more smoothly, do you think I did that every month? No, I got lazy. I wanted to open another restaurant. I wanted to see my kids and actually spend some hours at home, but I didn't, I got away from that. I recall not catching those things and how it affected me. So try to be diligent about it, right?

Patrick: And maybe we can do a whole episode on this, but I bet you can use AI to help you with that at this point.

Andy: Yeah. What's AI? No, I'm just kidding. All right.

Patrick: He was a really good basketball player.

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Andy: Very, very, very, very quick there, Patrick. All right, let's move on to number three. We kind of, we kind of touched on it a little bit, but let's dive in a little deeper.

Patrick: Yeah, so poor cost control. You know, I think one of the major, major things of owning and operating a restaurant is, you know, your controllables like labor, cost of goods, and other controllable costs, right? You have absolute control on these.

Like, you know, for instance, rent, it's going to be X amount of dollars for the entire year, and then next year it's going to go up by whatever, you know, percentage, and you know that. No matter what you do, there's no way you're going to be able to control that, right?

Well, you know, labor, cost of goods, you have absolute control of these two things, right? And you need to manage them on a daily and hourly basis, especially labor in today's time. It's so expensive, and if you have that extra person every single day that you just didn't cut because you don't need or...

Andy: It adds up to thirty, forty thousand dollars a year, I mean, for a for a dishwasher if you're not, if you're not managing right.

Patrick: I used to go through my P&L, you know, when you start doing millions of dollars, right? Let's say you're doing two, three, four, five million dollars a year, every percent matters. If you can shave off a percent, that's a good amount of money, right? And if you can cut a percent here, a percent there, a percent there, that's a lot of money every single month and year.

Andy: I think this is pretty self-explanatory. So, you know, and we kind of touched on how you can monitor this each month and so on. So number three was poor cost control. You've got to stay on top of your controllable costs, especially labor and cost of goods. You want to tackle number four?

Patrick: Yeah, I mean, number four, and this kind of touches on our last episode, use a pro. You know, a financial advisor, the correct accountant, the right

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attorney, having the right pro for the job is crucial and can save you money in the long run. It may cost you, you know, an attorney wage up front, but I bet you it could save you a lot of money on the back end.

Andy: Yeah. And I think just to reiterate to our listeners, using a pro is smart. You may pay a little bit more up front, but obviously, I think it's really going to be helpful and let you sleep at night and save you from issues down the road that can be very expensive and stressful. Please, please check out our previous episode, *Leave It to the Pros*. That really dives into it in much more detail, okay?

Number five, overpaying for your lease or location. Gosh, I didn't do this. Uh-huh. When you fall in love with a location and you have tunnel vision, it's kind of like dating someone who you have a great first date and you're like, this is great. I'm all in.

No, take pump the brakes, pump the brakes. Get your lawyer involved in the lease negotiations. Have a broker do some market research to see if the landlord is requesting rent that is far too high for this location.

I am blown away that in 2009, I was paying more for rent at my restaurant in San Francisco than the last two businesses that have been in my location that have closed. So at nearly 15 years have gone by, and I was paying higher rent in 2009 than they are in from 2020 onward there. It really blows my mind. I was paying a huge amount to this landlord.

We were able to produce enough volume to not make it a huge stress point, but I got such tunnel vision with this location, the patio, how much I loved it, and the growth opportunity there, and I didn't play hardball enough. And I didn't have a professional help me negotiate the hardball, right? So shame on me.

Patrick: Yep, I, you know, my big like, thing with the lease when I took over a lease, I had this clause in there, which was a percentage rent, and it was like, if you do more than a X amount of dollars, you have to pay a percentage. At the time, I said like, and we had to take the lease as is because it was an assignment of the lease, and there was no negotiation with it's one of the larger

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landlords in the city. And at the time, I was like, okay, well, if we're doing that amount of money, that's a really good problem to have.

Andy: Like a win-win, right?

Patrick: Yeah. Well guess what? When we started to do those numbers and, you know, yes, we were successful in the fact that we were able to do some good numbers, but then all of a sudden every quarter we were handing over another check for rent of, you know, twenty thousand dollars. And, you know, like in the bigger scheme of things, an extra twenty thousand every quarter, that's good money that you're giving away.

Andy: Sure.

Patrick: On top of the rent that you're already paying. So, you know, was it a good problem to have? I seemed to have, you know, justified it at the time, but I wish I, if I can go back now, I would, I would never sign myself up for something like that.

Andy: Let's back up on that detail. I love that example you just used, but there are situations where a hybrid, you know, base rent and a percentage rent, are fantastic if your base rent is below market, and then the percentage rent kicks in at a very respectable gross revenue volume, then this can be a win-win. And that sort of structure may show you that you have a landlord that is more of a partner than just someone trying to grab the extra dough.

Patrick: I guess then I would just say that, you know, given that there's probably like with these percentage rents, and yes, it does show that the landlord is willing to see this thing out and be a partner. However, you know, since there's a minimum base rent, so there's a floor, I feel like there should also be a ceiling, right? Like, because if you just give them in perpetuity a percentage rent and you're start doing, you know, five million dollars a year, you're handing over a lot of money.

Andy: Yep. True. True. All right. Well, I think we really summarized the top five for us. Do you want to go down the list just so we can remind our listeners what

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our top five were for the day? Our top five mistakes a new restaurateur can make?

Patrick: Yeah, let's do that. So number one, top financial mistakes of a new restaurant owner. Number one is going to be underestimating your startup capital and working capital needs. Number two, mispricing the menu. Number three, poor cost control. Four, use a pro. And number five, overpaying for your lease or location.

Andy: Great. So here's the question for you, Patrick. Which of our, on our top five lists, which was the one that you violated the most when you opened your own businesses?

Patrick: You had to go there. I'm going to have to ask you the same question, Andy. I would say, gosh, that's a hard one for me. I don't, you know, number one is obviously I, I started a little bit behind on the working capital, and so I would say number one, but I was able to correct it later on. And number five, I guess, given that I signed myself up for a lease that was, it's a great location. I caught up with the location and everything like that. And so the percentage rent thing I probably, now I would never do that. Yeah. And how about you, Andy?

Andy: I'm going to do this two ways. I'm going to pat myself a little bit on the back because I really worked for, you know, 15, 20 years with other very, very reputable restaurant brands, high-level chefs, chains, and so on. So I really felt I had the cost controls, the menu pricing, and all those things under control. And I feel like that was a successful thing that I did in opening my restaurant. I was ahead of the curve on that.

However, I was young, I had much more testosterone and muscles, and hair at that point, and I did not use the pros. I thought I could negotiate my own lease with this big-time landlord. I did not use a pro. So I violated number four, I violated number five. Use the pros, overpaying for my lease, okay? Those two are very related.

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So there it is. Thanks, guys. We've uh, exposed ourselves a little bit today too, but thanks for listening to *Restaurant Deal Making EXPOSED!* Have a good day.

Thank you all for listening to this week's episode of *Restaurant Deal Making EXPOSED!* If you're considering selling your business and would like a free consultation, reach out to patrickAndAndy@therestaurantsalesbroker.com or visit TheRestaurantSalesBroker.com to learn more.