Case Study

Question: When is a Loss Really a Profit?

One of a series of reports of the results of Clarion projects, illustrating ways in which dining services are improved and new opportunities to increase value are created. Names and identifying details are omitted to protect our client's anonymity.

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The company's contract with its food service provider called for a sharing of operating profits. But after two years, there were no profits to be shared.

The contractor showed losses month after month and was still cheerful. How could this be, the company's management wanted to know. At the same time, management was concerned with the perceived high cost of service in its executive dining rooms.

Clarion was retained to explore both issues.

THE SITUATION: With some 1,300 employees, the company had more than $3 million in total dining service sales, of which $1.3 million was in catering activity. The operating agreement provided that any profit, after the contractor's administrative charge, would be shared by the company and the contractor.

Executive dining services are billed at a fixed charge per guest, depending on the service provided – luncheon, continental breakfast or other type of event. Other catering services range from refreshment deliveries to dinners and receptions for as many as 300 guests.

WHAT WE FOUND: There were two sets of problems with different solutions.

Executive Dining: We interviewed the administrator who managed executive dining and the contractor's on-site manager and district manager.

We found the administrator wanted to upgrade the services, while the contractor was concerned with the ordering process. They received the confirmed number of guests to be served at 10:00 a.m. of the day of service, causing inefficiencies and sometimes, extra costs.

Profit or Loss: The prior and current years' financial statements submitted to the client showed that, indeed, the contractor was reporting operating losses. Most of the losses were recorded in the staff café.

But an examination of the operating statements, the general ledger (a record of all the transactions that make up each line in the statement) and daily sales reports revealed a different picture.

Staff café meals charged to the company were deducted from café sales as "overrings" and credited to the catering account, reducing café sales by some $17,000 a year. In one month, more than $6,000 was deducted from café sales for cash payouts, some as high as $1,700 in a single day. These lax practices meant there was no cashier or manager accountability and no cash control.

Most purchases were charged to the café, with portions allocated to executive dining and other catering. But the allocations were arbitrary, not based on actual usage.

As a result of these practices, neither the client or the contractor knew the real cost of the components of the dining service. There was no way to identify understated sales or excess costs, or to correct them.

We found the contractor had increased its administrative charge above the limit set in the operating agreement and added a separate, additional "service charge." Charges for wage-related

taxes, insurance and benefits and for liability insurance far exceeded actual costs.

When these excess charges and a conservative estimate of vendor rebates were factored in, we found the contractor was actually making a profit.

Unfortunately for the company, the operating agreement put no limit on these charges and expressly permitted the contractor to retain its vendor rebates.

RECOMMENDATIONS: Under the circumstances, we advised the company that the executive dining prices were reasonable. They might be reduced if the guaranteed number of guests could be provided on the preceding afternoon, so the contractor could plan better for each day's service.

We also recommended ways in which the service could be upgraded.

As soon as we notified the contractor's district manager, the payments for charged meals were credited to the café, instead of catering. He also agreed to establish a more accurate system for allocating food and other costs from the café to other units. But he didn't change the system of paying for purchases and temporary workers from cash receipts.

We suggested to management that, instead of expecting a share of profits, they should take a one or two percent commission on sales. That way, they wouldn't have to be concerned about the contractor's charges to the operation.

CLARION'S CONTRIBUTION: We had the knowledge and experience in food service operations and contractors' practices the company lacked. We also could provide an objective view of the operation and offer equitable solutions to the issues. The financial questions will be resolved in a new contract.

Clarion can analyze the operational and financial issues in your dining, conference, catering and other facilities services and find and implement the solutions that will improve the systems and reduce costs. For information, contact tom Mac Dermott, president, 603/642-8011, Angela Phelan, senior vice president, 973/544-6223 or Ernie Wilder, 904/940-1208 or e-mail us at info@clariongp.com.