

Budgeting Assignment

Budgeting involves judgment (e.g., projecting uncertain events based on incomplete information) and mechanics (e.g., combining and analyzing information, primarily financial information). This assignment requires that you combine good judgment and mechanics.

The assignment involves a hypothetical company, Barnes Catering (henceforth, BC). Owner Beau Barnes describes his company as “dedicated to making a profit while respecting the work/life balance of employees”. Having worked in the catering industry for many years before starting his own company, Mr. Barnes believes motivated and happy employees are critical to success in the catering industry. That said, Mr. Barnes is businessman. Like most businesspeople, Mr. Barnes desires a solid return on investment.

BC currently employs nine people – all are part time. Each BC employee works, on average, 20 hours per week. During busy weeks, employees average about 30 hours per week (but this is rare). BC’s employees value their part-time employment arrangement because the flexibility allows them sufficient time for significant others (e.g., children) and other interests. As hourly employees, BC employees earn more during busy weeks; however, they prefer the flexibility of the ‘normal’ 20-hour per week schedules. In spite of this preference, BC employees are dedicated because they respect Mr. Barnes and realize an equivalent work arrangement would be hard to find elsewhere. Although it sounds trite, the BC employees are a good team.

Increased Competition Requires Tough Decisions

Recently, the catering business has become more competitive. Competitive forces have required Mr. Barnes to reduce catering prices. This, in turn, has reduced BC’s total profit.

The change in business environment (more competitive pricing) poses additional complications for a decision Mr. Barnes faces. BC’s lease will soon expire, and Mr. Barnes must decide whether to extend the current building lease or sign a new lease on a larger, more modern building.

Although small, the **current building** is inexpensive. The kitchen can accommodate only 4 or 5 employees (who prepare food for catering events). Given BC’s current clientele (mid-sized business events and small weddings), a 5-employee kitchen works fine.

In contrast, Mr. Barnes has identified a **prospective building** that would be larger but more expensive. This building can accommodate all nine employees preparing food at the same time. With the larger building, BC could target larger clients (but employees would work longer hours).

The Assignment

Imagine Barnes Catering is a client and you are an accountant (a good one). Using the information provided, Mr. Barnes has asked you to prepare the following unbiased forecasts:

1. A 'steady-state' forecast (based on renewing the **current building**)
2. A 'growth' forecast (based on signing a lease in the **prospective building**)

Mr. Barnes openly acknowledges that higher profits are likely available under the 'growth' scenario. That said, Mr. Barnes requests an unbiased forecast from you because he will consider many factors (e.g., his employees, his personal preferences, etc.) when making his decision... financial forecasts are merely one bit of information (albeit an important one) to Mr. Barnes.

Mr. Barnes is confident that you will provide solid projections for each scenario (steady-state and growth).

Having worked for Mr. Barnes many times in the past, you are well aware that his 'bottom line' is return on investment (ROI). As such, your final number for each of the scenarios will be ROI.

Tips for the Assignment

- ◆ **Assume zero time-value of money (i.e., no inflation adjustments or present value calculations). Here, the ROI focus is presumed to capture (typically) important time value of money effects.**
- ◆ **Keep your time frames consistent. Information is often provided over different time horizons (years, months, weeks). Be sure your timeframes 'match up'.**
- ◆ **Be unbiased. Creating each scenario will require judgment; however, you are tasked with unbiased estimates (i.e., don't "tilt" your analysis because you have a personal preference for either the "growth" or "steady-state" strategy).**
- ◆ **Both forecasts (growth and steady state) must be feasible alternatives for Mr. Barnes. (For example, you can't put six employees in a 5-employee kitchen).**

Restrictions when creating your budgets

- ◆ The average wage rate must remain constant.
- ◆ The number of employees (9) must remain constant.

**Barnes Catering
Income Statement
Year Ended Dec. 31, 2008**

		Notes:
Revenue	\$ 417,545.81	1
Employee wages and benefits	(\$177,430.16)	2
Cost of Food	(\$53,843.11)	3
Occupancy and other costs	<u>(\$64,559.58)</u>	4
Taxable Income	<u>\$ 121,712.96</u>	
Return on Investment	38%	5

Notes

- 1** Actual revenue (provided above) is the summation of customer receipts; however, this figure reconciles (with minor error) to the following weekly averages.
\$45 price per plate × 15 people per job on Tuesday, Wednesday & Thursday.
\$50 price per plate × 40 people per job on Friday, Saturday & Sunday.
BC can do only one catering job per day.
- 2** Actual wages and benefits (provided above) is the summation of employee W4 forms. This figure reconciles (with minor error) to the typical weekly work schedule: Three 20-hour per week employees on Tuesday through Thursday, four 20-hour per week employees on Friday through Sunday, and two 20-hour per week employees who 'float' to jobs as needed. An \$18 'full wage and benefit' rate is very accurate.
- 3** Actual food costs (provided above) is the summation of all payments to vendors; however, this figure reconciles (with minor error) to an average cost of \$7 per plate on Tuesday through Thursday and \$6 per plate on Friday through Sunday (lower cost due to economies of scale).
- 4** Actual lease costs (\$2,300 / month), equipment lease payment to Advantage Leasing (\$761 / month) delivery truck lease payment (\$1,089 / month), insurance (\$333 / month), and other expenses (\$900 / month). Fuel and accounting services are the largest 'other' costs.
- 5** ROI = Taxable Income / Investment. Consistent with past years, "Investment" assumes all long-lived assets (building, van, equipment) were purchased rather than leased. The investment that would have been required to purchase these items is \$316,765.

A Message from: Beau Barnes

Barnes Catering
719 Broad Street
Arlington, TX 76006

Thank you for addressing my financial projection request so quickly.

As you know, I will make an important strategic decision about the company very soon (new lease agreements must be signed). Please do your best to provide your unbiased projections (keep in mind, your projections are only one input to my final decision).

The following projections should be helpful:

1. Although the general economic outlook is not favorable, the local economy is doing relatively well. I don't foresee major growth or decline in the catering market (as a whole).
2. Current pricing pressure from our new competition is likely to continue. I foresee a small price reduction for the early-in-the-week jobs (T, W, & Thursday). For the larger weekend jobs, the situation is complicated. If we remain in the current building, I plan to pursue some larger jobs; hopefully increasing the average job size to 50 (maybe a bit optimistic). In this case, employees must work more hours per week (on average). In addition, I expect to reduce the price-per head in order to acquire larger jobs. Our competition is currently charging \$41 per head on the weekend. We can charge (slightly?) higher rates than the competition and remain fully booked. We are currently below \$50 per head (on average).
3. In the large building (with a larger delivery vehicle), we can be more aggressive. With more scale, I could pursue more business (e.g. weddings & major corporations), and our average weekend job would be at least 55 heads. Optimistically, we could hit 70. The high-end would push employees to about 30 hours each week. In addition, employee's work schedules would be less flexible. Pricing for larger jobs should be marginally higher than what I could get in the current building (because very large jobs tend to be less price sensitive). I don't believe the larger scale would help in the early part of the week (the business just isn't there).
4. After extensive price-shopping, Advantage Lease is still the best deal for equipment (Leasing Schedule attached). Regardless of the eventual location, the Advantage rates that I provided will be honored.
5. Food costs (per head) will likely be constant for the foreseeable future.
6. Non-lease-related "Other" costs would likely increase by 25% to 35% at the larger building (utility and fuel costs being the primary driver).

Barnes Catering Lease Capitalization Schedule Year Ended Dec. 31, 2008

Note: Mr. Barnes leases by choice. This schedule provides the 'capitalized' amount for these commitments (roughly equal to "investment"... The denominator in Mr. Barnes' ROI figure)

Past investment calculation (all leases expire this year):

<i>Item</i>	<i>Monthly Payment</i>	<i>Capitalized Amount</i>	
Building	(2,300)	226,765	(rate 9%, n = 15 yrs.)
Delivery Van	(1,089)	55,000	(rate 7%, n = 5 yrs.)
Advantage Lease	(761)	35,000	(rate 11%, n = 5 yrs.)
Total	(4,150)	316,765	

Advantage restaurant lease items: Viking refridgerator, rotisserie oven, commercial dishwasher convection oven, chest freezer, commercial range.

Steady State lease opitions:

<i>Item</i>	<i>Monthly Payment</i>	<i>Capitalized Amount</i>	
Building	(2,200)	204,726	(rate 10%, n = 15 yrs.)
Delivery Van	(958)	52,000	(rate 4%, n = 5 yrs.)
Advantage Lease	(829)	39,000	(rate 10%, n = 5 yrs.)
Total	(3,987)	295,726	

Controlled growth lease options:

<i>Item</i>	<i>Monthly Payment</i>	<i>Capitalized Amount</i>	
Building	(3,400)	299,139	(rate 10%, n = 15 yrs.)
Large Delivery Van	(1,327)	67,000	(rate 4%, n = 5 yrs.)
Advantage Lease	(977)	46,000	(rate 10%, n = 5 yrs.)
Total	(5,704)	412,139	

A Merry Chef accelerated cooking oven can fit in the large building (enables more food volume)

Name _____

FORMAT – Please use the same format as the current Income Statement (including supporting notes).

Next Year's Projected Income Statements for the:

	Steady State Scenario	notes	Controlled Growth Scenario	notes
Revenue		1		2
Employee wages and benefits		3		4
Cost of Food		5		6
Occupancy and other costs	_____	7	_____	8
Taxable Income	=====		=====	
Return on Investment		9		10

Explanatory Notes:

1. Projected Revenue (Steady State)

2. Projected Revenue (Controlled Growth)

3. Employee Wages and Benefits (Steady State)

$$9 \text{ (employees)} * \$18 \text{ (per hour)} * 52 \text{ (weeks)} * \frac{\text{_____}}{\text{(avg. work week)}} = \frac{\text{_____}}{\text{(ttl. wages/benefits)}}$$

Explanatory Notes Continued...

4. Employee Wages and Benefits (Controlled Growth)
 $9 \text{ (employees)} * \$18 \text{ (per hour)} * 52 \text{ (weeks)} * \frac{\quad}{\text{(avg. work week)}} = \frac{\quad}{\text{(ttl. wages/benefits)}}$
5. Cost of Food (Steady State)
6. Cost of Food (Controlled Growth)
7. Occupancy and Other Costs (Steady State)
8. Occupancy and Other Costs (Controlled Growth)
9. ROI (Steady State)
10. ROI (Controlled Growth)