



Restaurant  
& Catering

# Productivity Commission

Public Inquiry: Business Set-up, Transfer and Closure

FEBRUARY 2015

## RESTAURANT & CATERING AUSTRALIA

Restaurant & Catering Australia (R&CA) is the national industry association representing the interests of 35,000 restaurants, cafes and catering businesses across Australia. R&CA delivers tangible outcomes to small businesses within the hospitality industry by influencing the policy decisions and regulations that impact the sector's operating environment.

R&CA is committed to ensuring the industry is recognised as one of excellence, professionalism, profitability and sustainability. This includes advocating the broader social and economic contribution of the sector to industry and government stakeholders, as well as highlighting the value of the restaurant experience to the public.



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## BUSINESS ENTRIES & EXITS

### in the Café, Restaurant & Catering sector

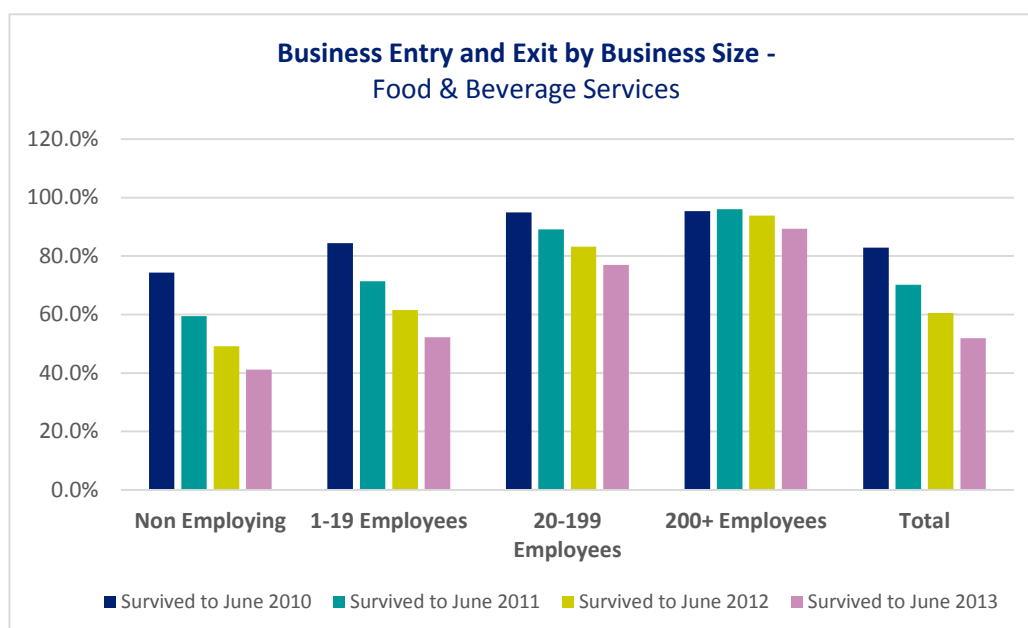
The restaurant, cafe and catering sector is one of the most dynamic sectors of Australia's economy. Businesses open and close with relative ease at the rate of 20 per cent per annum.

Whilst this is the case, the sector is far from an efficient market. The rate of entry and exit leaves a legacy of debt in the hands of suppliers and landlords, while resulting in huge personal and emotional debt to the operator.

The stock of restaurant, café and catering businesses has remained fairly stable in recent years. Overall, one in two hospitality businesses survives four years of operation (51.9 per cent). This rate is significantly lower for non-employing businesses, at 41.1 per cent and significantly higher for big businesses (89.4 per cent). A significant proportion of the sector however are small businesses (93.1 per cent).

	Operating June 2009	Survived to June 2010	Survived to June 2011	Survived to June 2012	Survived to June 2013
<b>Non-employing</b>	16,162	12,012	9,615	7,948	6,644
		<b>74.3%</b>	<b>59.5%</b>	<b>49.2%</b>	<b>41.1%</b>
<b>1-19 Employees</b>	41,685	35,208	29,753	25,637	21,776
		<b>84.5%</b>	<b>71.4%</b>	<b>61.5%</b>	<b>52.2%</b>
<b>20-199 Employees</b>	6,090	5,782	5,432	5,066	4,686
		<b>94.9%</b>	<b>89.1%</b>	<b>83.2%</b>	<b>76.9%</b>
<b>200+ Employees</b>	237	226	217	212	202
		<b>95.4%</b>	<b>96.0%</b>	<b>93.8%</b>	<b>89.4%</b>
<b>Total</b>	64,174	53,228	45,017	38,863	33,308
		<b>82.9%</b>	<b>70.1%</b>	<b>60.6%</b>	<b>51.9%</b>

Source: Australian Bureau of Statistics: Business Entry and Exit, Food and Beverage Services

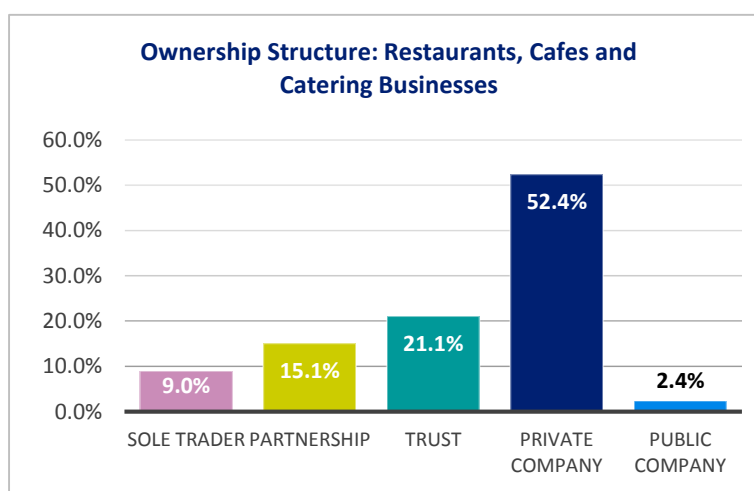


## BARRIERS TO ENTRY

The restaurant, café and catering sector is a highly regulated sector, subject to multiple layers of regulation at a federal, state and local government level. The biggest areas of regulation occur around the provision of food, the service of alcohol, and the labour intensity of the sector.

## GOVERNANCE STRUCTURE

R&CA's 2014 Industry Benchmarking Report found that a majority of restaurant and catering businesses are companies (52.4 per cent), with trusts the second most common ownership structure at 21.1 per cent, and 22.2 per cent of businesses operating as either sole traders or partnerships.



This preference for a corporate structure was, in the past, predominately driven by favourable industrial arrangements. Recent experience demonstrates it is now being driven by favourable tax

treatment. However, a private company structure does add an overlay of additional regulation on these businesses, including the development of a constitution, registration, annual returns and Annual General Meetings. This is also the case, to an even greater extent, for trusts.

## LICENSES & APPROVALS

There are multiple licenses and approvals required to operate a restaurant, café or catering business which can form a significant barrier to entry. The requirements of each license and approval may vary significantly from jurisdiction to jurisdiction.

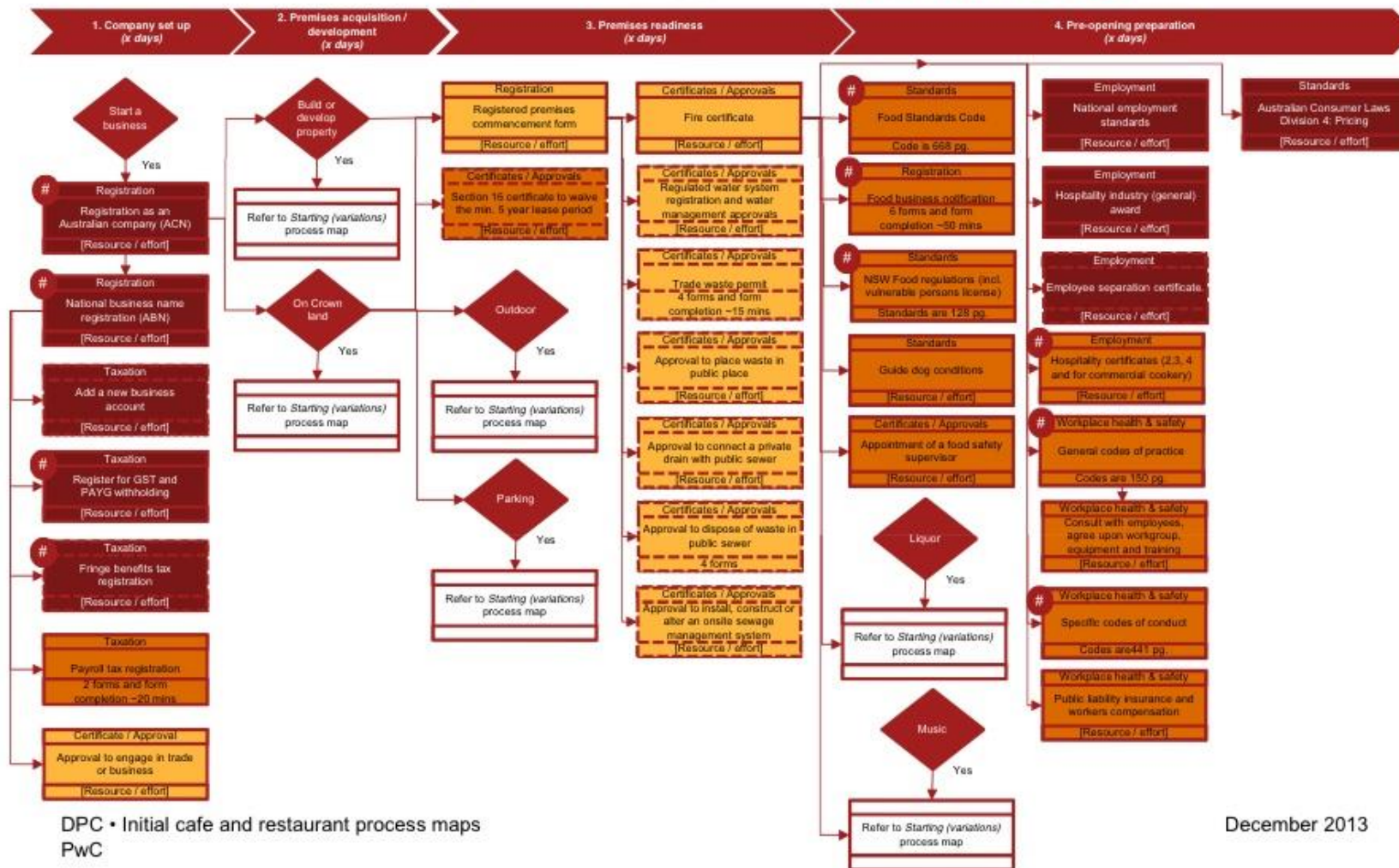
The proceeding flow charts on pages 6 and 7 were drawn from an investigative study undertaken by PricewaterhouseCoopers for the NSW Government, examining the areas where businesses engage with government on compliance or regulatory matters. The charts highlight the considerable number of licenses, approvals, and regulatory requirements hospitality operators must meet when starting and operating their business including:

- ABN/ACN Registration
- Trade Waste Permit
- Registration as a food business
- Food Safety Supervisor training
- OH&S Workplan/Agreement
- Lease term approval (waiver of 5yr min)
- Outdoor dining approval
- DA for outdoor dining
- Liquor Licence application/approval
- Music/broadcast license

The charts demonstrate the significant overlap that can occur between different licenses, as well as the overlap that can sometimes span all three levels of government. In many cases licenses require multiple applications requesting the same information to be provided to the same level of government.

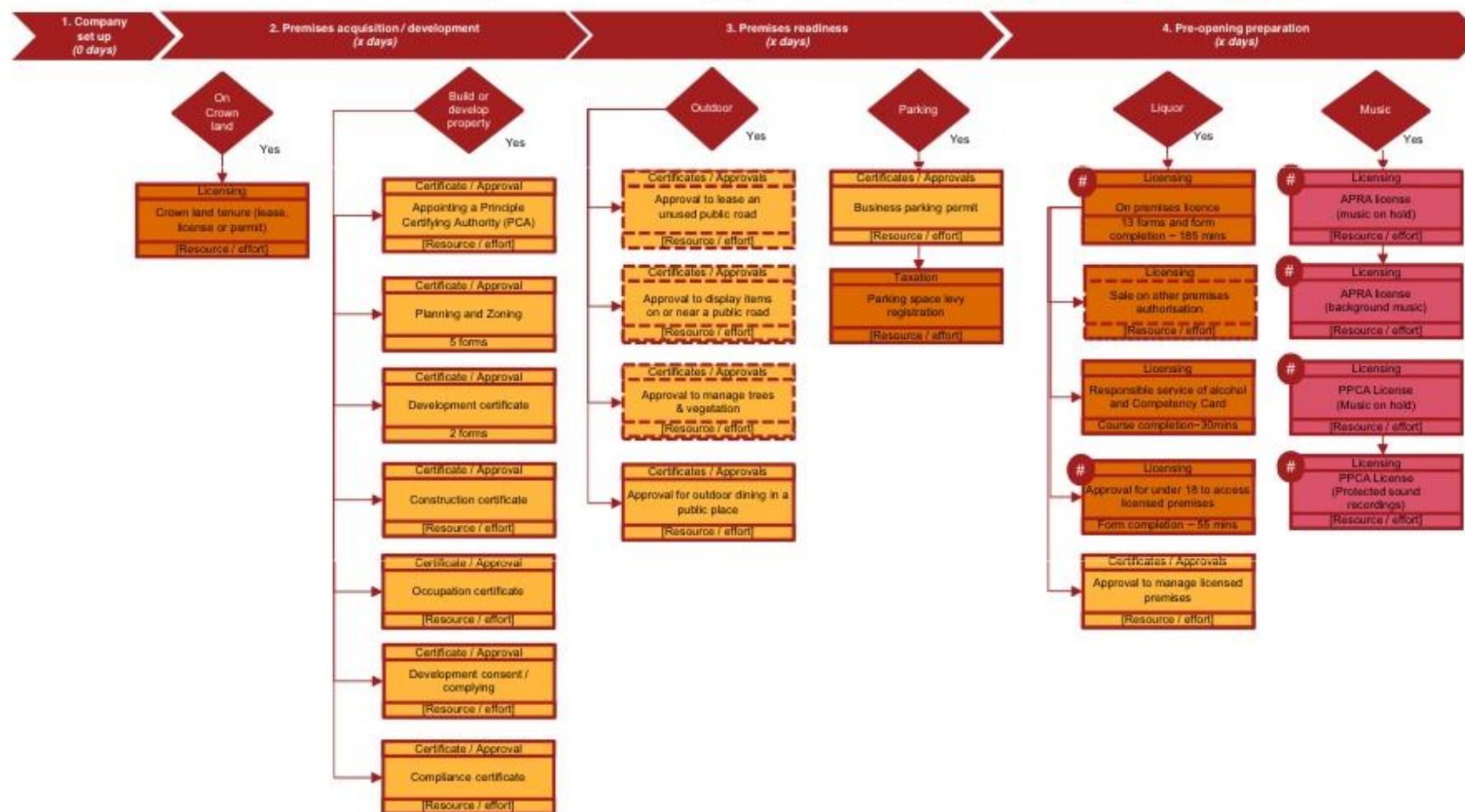


## Cafe and restaurant process mapping – Starting (core)



December 2013

## Cafe and restaurant process mapping – *Starting (variations)*





## Recommendation

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R&CA believe that where the same level of government is engaged with a business, whether it be at the start-up phase or during operation, that applications should be streamlined (ie. state-based registration of food businesses, liquor licenses, or trade waste). Specifically, standard information for a business should only be required to be submitted once.

In addition, where approvals are being sought across two levels of government (ie. outdoor dining), the same information should be able to be used for both applications. In addition, if one level of government is satisfied the operator has met the requirements of a license and has approved the license or permit, this should be accepted at the other levels of government (ie. the requirement for a Development Application be waived if an outdoor dining approval has been received).

## NEW BUSINESS MODELS

New business models are beginning to emerge within the industry as businesses attempt to control costs and reduce overheads. The competition from new business models such as food trucks and pop-ups that operate at a lower cost, lower regulatory environment can place traditional restaurant establishments at a disadvantage, albeit this is yet to be wide-spread in Australia.

Under various circumstances these business models may avoid the following licenses/applications:

Application / Permit	When not required
ABN/ACN Registration	Sole Trader under GST threshold
Trade Waste Permit	No commercial kitchen
Registration as a food business	No commercial kitchen
Food Safety Supervisor training	No commercial kitchen
OH&S Workplan/Agreement	Non-employing business
Lease term approval (waiver of 5yr min)	No commercial kitchen
Outdoor dining approval	No outdoor space
DA for outdoor dinning	No outdoor space
Liquor Licence application/approval	Doesn't serve liquor
Music/broadcast license	No background music

Given the nature of the industry, a majority of non-employing food truck and pop-up businesses are catering businesses, many of which operate out of domestic kitchens. These so-called 'back yard' catering operations create a distortion in the market given they operate without the regulation larger caterers face when operating a commercial kitchen.

This potentially provides an incentive for higher risk businesses to operate with the lowest level of regulation. Catering businesses are widely acknowledged as higher-risk operators in the sector<sup>1</sup> and these new business models are being encouraged by the regulatory system to operate without a commercial kitchen, as non-employing businesses, and without registered food vehicles. In this way the regulation in the sector is promoting the sustainability of high-risk hospitality businesses.

Levels of entry are also distorted by other areas of various government policy. In the immigration area, for example, the investor visa category allow investors - with in effect fairly small sums of money - to open a business in Australia. These investors often open a business in the hospitality sector that has very little chance of ever being viable. These 'false entries' into the market effectively draw from the industries resources (staff, raw produce etc) without the need to operate viably. In effect they buy market-share in Australia to enable them to operate through the threshold period to earn their visa or residency.

## Recommendation

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R&CA would encourage Government to ensure a level playing field for all hospitality operators by examining thresholds and exemptions from regulation that unwittingly make high-risk business models more viable compared to businesses that consistently meet regulatory requirements.

Government should also review incentive schemes, such as investor visas, to ensure that they do not distort the market in a particular industry or sector.

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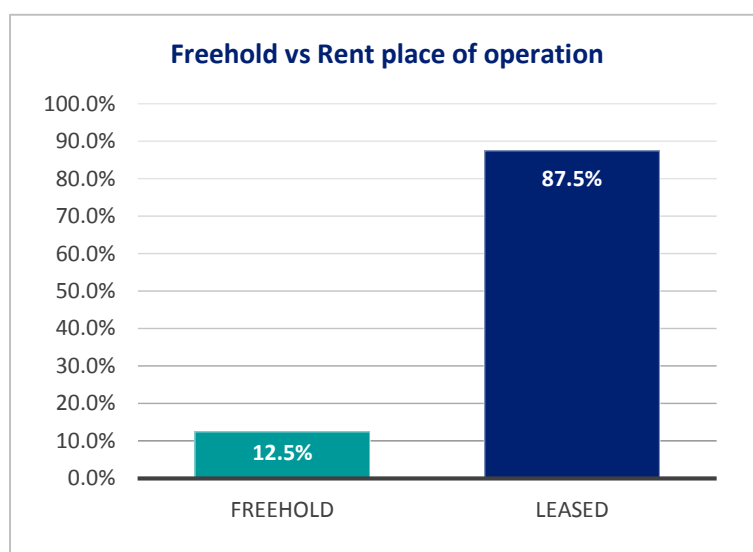
<sup>1</sup> Food Safety Programs, A guide to Standard 3.2.1 *Food Safety Programs*, First edition, June 2007

## ACCESS TO FINANCE

Businesses in the restaurant, café and catering sector have significant issues accessing finance at a reasonable cost. Most business owners are forced to borrow from individuals in the business that have mortgaged their homes to provide the capital required. Others, looking for small amounts, are asked to draw down on credit cards to cover the cost of capital acquisition.

Hospitality businesses are viewed very dimly by financial institutions and are not accessible by large enough groups of consumers to be able to source 'crowd funds'. Most operators of these businesses also do not have a high level of financial literacy to make this achievable. With increasing business interest in Australia from major source markets in Asia, the industry is seeing more creative businesses started by entrepreneurs from these markets that do not necessarily have the financial skills to develop business plans and prospectuses that would be regarded as satisfactory to any lending institution.

One of the most effective ways for restaurants, cafes and caterers to access finance is by owning the freehold of the property they occupy. This provides operators with greater security as they have a greater prospect for securing finance against the asset and are therefore able borrow at a more reasonable rate. However, in most cases operators rent their place of



business, with R&CA's *Industry Benchmarking Report* revealing only 12.5 per cent of businesses own the property from which they operate. However, these business have a far greater chance of successful exit from the industry, should they choose to do so. It is these businesses that should be able to access accumulated superannuation through self-managed super funds to purchase property.

### Recommendation

Government should consider policy settings that encourage businesses to own their premises freehold including - among other things - maintaining the capacity for businesses to own premises through self-managed super funds.

## BUSINESS EXITS

### STAFF COSTS

Whilst from an economic standpoint the effective operation of the 'market' may see unviable businesses going out of business, the disruption business closures cause employees is significant. Given the labour-intensity of the restaurant, cafe and catering sector, business closures have a greater effect on staff than in other industries.

With labour costs accounting for some 45 per cent of turnover<sup>2</sup>, the high cost of labour places considerable financial pressure on operators and often contributes to a greater number of business closures.

Non-wage labour costs are also very high given the labour intensity of these businesses. These costs, (which can represent up to 15 per cent of turnover) are often the first to go unpaid when businesses are facing closure. These include PAYG, Workers Compensation Insurance and Superannuation. The disruption to staff displaced by unpaid entitlements from a business closure is significant.

### ASSET COSTS

The high rate of entry and exit in the restaurant industry means that often business values are lower than the real value of their assets. This results in the majority of business owners walking away at the end of the business cycle. This regularly occurs when a landlord locks the business owner out and is left trying to recover some of the foregone rent through selling any assets that remain.

### INSOLVENCY ARRANGEMENTS

Most hospitality businesses will generally continue to trade 'as normal' until the point at which they cease trading all together. This is because a hospitality business saves very little in its cost-base by gradually winding down its operations (predominantly due to their very high labour intensity). This trend exacerbates large residual debts in staff-related costs (as outlined above).

At a 50 per cent attrition rate and 50 per cent of entities being corporations, the restaurant, café and catering sector would, overall, benefit from corporate insolvency laws that encourage and facilitate

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<sup>2</sup> R&CA (2014) *Industry Benchmarking Report*, Financial Results 2012-13

corporate turnarounds. The current arrangements provide little incentive to businesses to control the end of the business's life-cycle as insolvency options provide little likelihood of 'turnaround'.

An arrangement similar to the 'Chapter 11' processes in the US may work for corporations in Australia. Care must be taken, however, to balance the cost of the process and the protection of unsecured creditors to ensure that the tendency to liquidate does not prevail in a new system just as it does in the current Australian system.

### **Recommendation**

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Government should give consideration to changing insolvency laws such that the focus is on encouraging and facilitating turnarounds as opposed to encouraging liquidation.



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