



Impact of COVID-19 on Finance and Operations in the Chinese Catering Industry

Deloitte China and China Cuisine Association

March 2020



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Survey background

Since the outbreak of COVID-19, Chinese catering companies have suffered a **massive direct** impact. The majority of catering companies (particularly SMEs) have faced sharp declines in customer numbers, ruptured asset chains, or other momentous challenges.



The **China Cuisine Association** and **Deloitte China** surveyed the Impact of COVID-19 on Finance and Operations in the Chinese Catering Industry from mid-February to early March this year to better grasp the difficulties and challenges in catering businesses' operations and finance, and to derive a suite of proactive, effective countermeasures Deloitte is able to provide. The findings promise more precise assistance for enterprises at this difficult time and provide strong evidence for greater policy support.

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Crises, although dangerous, are often said to represent new opportunities. The COVID-19 pandemic has dealt an unavoidable blow to the catering industry, but many companies can navigate this “baptism of fire” with the right countermeasures to strengthen their immunity, financial and operational management systems, develop a sharper competitive edge and be better positioned for the consumption rebound to come.



Survey findings

Our findings from gathering and organizing information on companies' circumstances, the outbreak's impact, companies' counter-strategies and developmental needs include:

01

94% of catering enterprises' dine-in services have been affected, including a more than **80%** decline in dine-in customer numbers for **69%** of companies

02

65% of respondents have strengthened cash flow oversight in response to the pandemic. The main areas of pressure now include:

- **Wage costs**
- **Cash clawbacks**
- **Rent**

03

More than **80%** of businesses expect to need additional financing in the next six months



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Survey findings

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04

About **80%** of respondents have downgraded their performance outlooks, **over half** by more than 50% from their original 2020 forecasts

05

Survey respondents are most hopeful of receiving **three major supports**:

- A reduction or delay in tax payments
- A reduction or delay in “five insurance and housing fund” payments
- Post-outbreak rent reductions or relief



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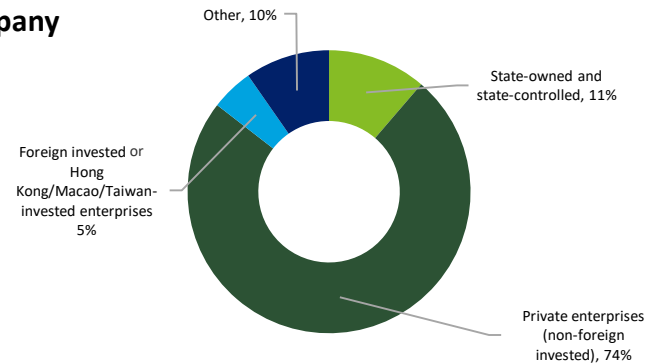
Overview of respondents

Type and location of company respondents

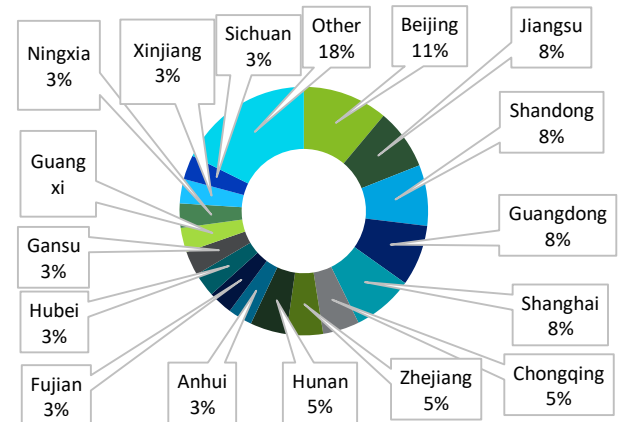
Type and location of respondents

- The survey covered every type of enterprise. Private enterprises (non-foreign invested) made up about three-quarters of respondents, followed by state-owned enterprises at 11%
- Respondents came from 26 provinces and major cities across China, with Beijing, Jiangsu, Shandong, Guangdong and Shanghai together representing a majority

Type of company



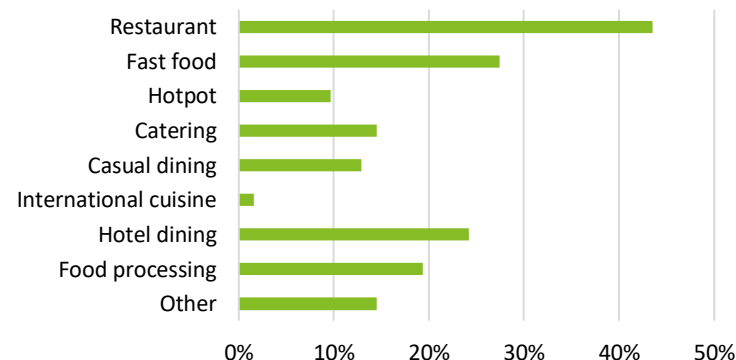
Location



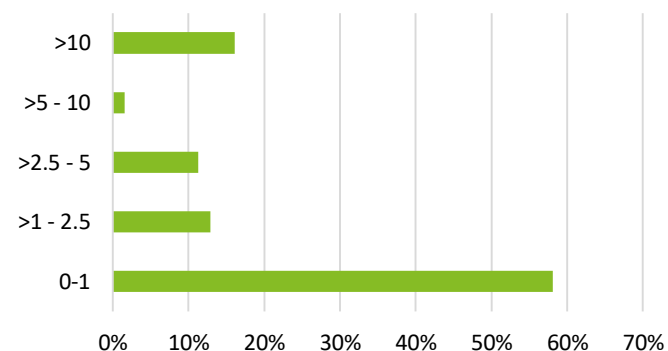
Segments and revenues of company respondents

- Catering businesses operating on a **restaurant** model constitute the largest group of respondents at 44%, followed by fast food businesses at 27%, and then hotels, food processors and caterers. Relatively few respondents are from the international cuisine segment
- About 58% of respondents' annual revenue is **RMB100 million or less**, 13% have annual revenue above RMB100 million but below RMB250 million, and about 16% have annual revenue of more than RMB1 billion

Primary segment



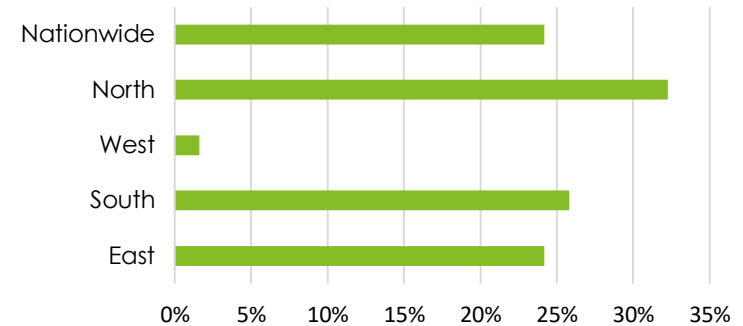
Revenue (RMB100 million)



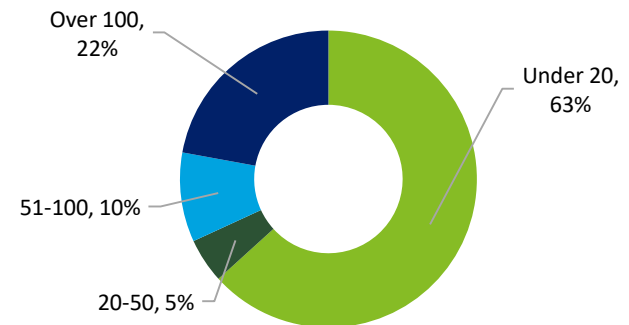
Distribution and number of outlets of company respondents

- Respondents are quite **uniformly** distributed across China, with the exception of there being fewer outlets from West China. About 32% of businesses are based in North China, some 26% are in South China, around 24% are in East China and approximately 24% are national operators
- About 63% of respondents run **fewer than 20 outlets**, around 5% have 20-50 outlets, some 10% have 51-100 outlets, and 22% have more than 100 outlets

Distribution of outlets



Number of outlets

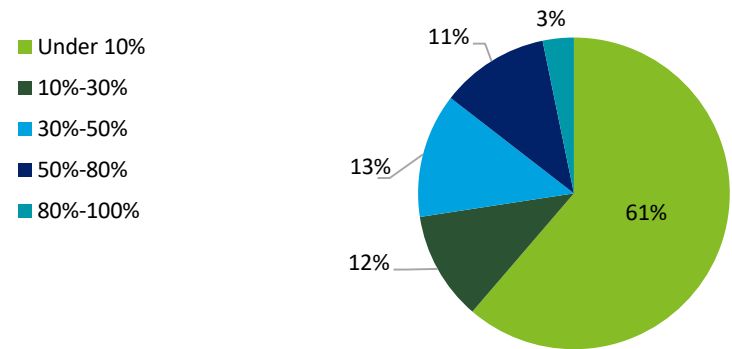


Companies' predicaments during the pandemic

Re-opening and the impact on dine-in customer numbers

- The survey findings indicate about 60% of businesses had reopened less than 10% of their outlets by early March. Approximately one-quarter of enterprises had reopened between 10%-50% of outlets, but less than 4% had reopened 80% or more
- 94%** of catering enterprises' dine-in services were affected after reopening. 69% say dine-in customer numbers decreased by more than 80%, and only 6% say the pandemic has had no impact on dine-in customer numbers

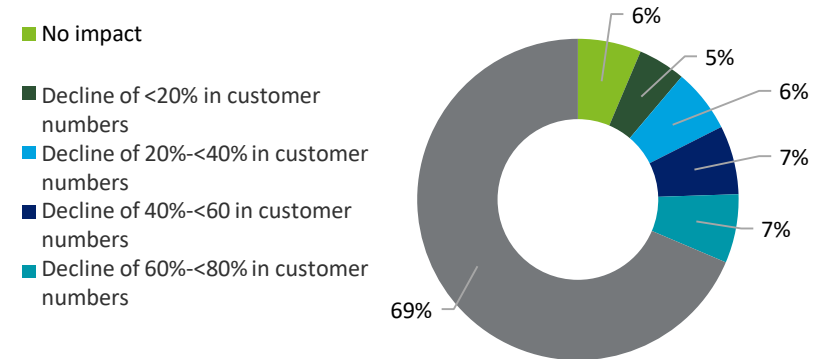
Proportion of outlets reopened



Countermeasures

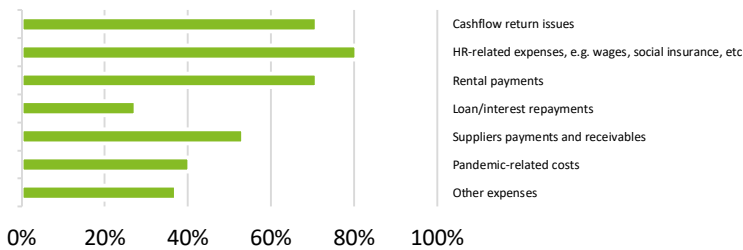
- Catering companies have been particularly damaged by heightened concerns around public gatherings and food safety during the pandemic, illustrated mainly by sharp declines in dine-in customer numbers. Hospitality companies can pay extra attention to the management of their food and ingredient inventories and supply chains, as well as carefully monitor and undertake daily disinfectant and cleaning procedures, giving themselves extra reserves in the battle against the virus
- Companies might also **re-examine business formats or asset structures**; large enterprises can consider **setting up their own online services systems**, whereas small to medium-sized enterprises might prefer **partnerships with online platforms** to better satisfy public demand for online consumption through online-offline partnerships. This could help businesses locate new growth areas, accelerate their transformations and reduce risk vulnerabilities

Impact of pandemic on dine-in customer numbers



Corporate cash flows and finances

Main sources of cash flow pressure since the outbreak

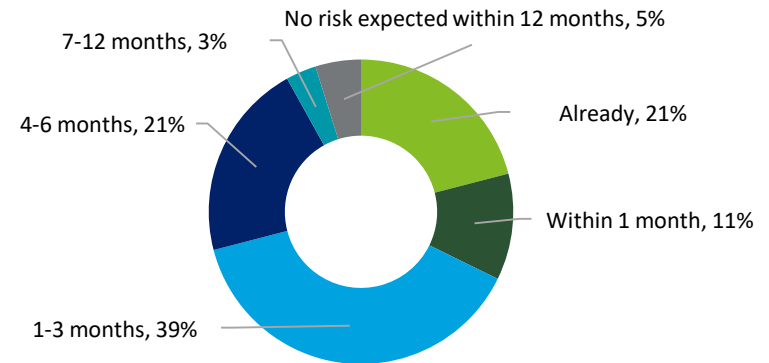


- The main sources of pressure on businesses' cash flows since the pandemic are **wage payments, social insurance and other HR expenditures**, with cash flow return and rental payments also having a major impact
- Respondents reported **substantial declines** in Q1 2020 revenue forecasts. About 16% of companies forecast no revenues, some 70% forecast a more than 70% slide in revenues, and only about 7% forecast no change or continued revenue growth
- The survey found **21%** of businesses have already found themselves unable to meet outgoings, 50% expect to face this risk in Q1, and only 5% expect no such risks within a year

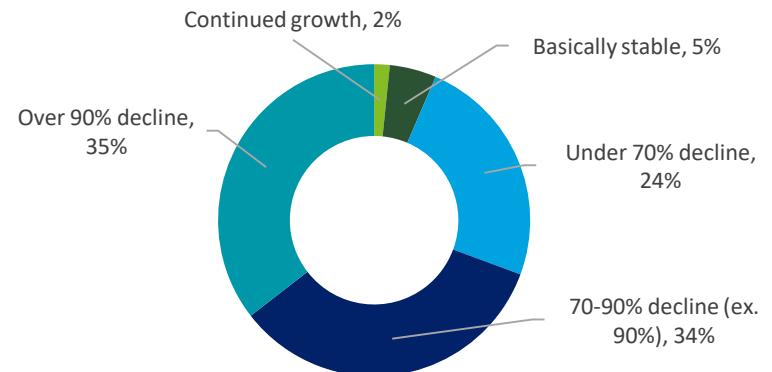
Countermeasures

- Catering companies can address liquidity risks with **enhanced financial management provisions** and **robust, continuous and effective mechanisms for dialogue** with their stakeholders to seek further support. For example, companies can seek to negotiate rent reductions or relief, fight for extensions of payment terms with upstream suppliers, loan support and better conditions from financial institutions, or rebates, delays and even exemptions from tax and social insurance obligations

Expected risk of not meeting outgoings within 12 months

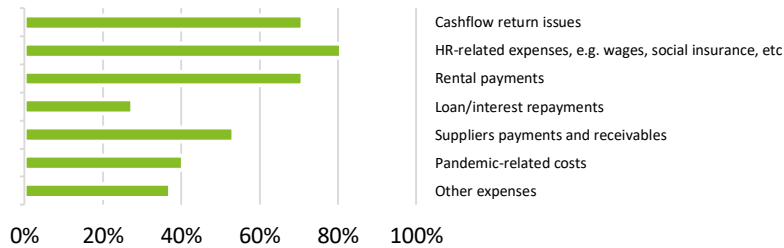


Changes to company Q1 revenue forecasts against 2019



Staffing needs and affected departments

Departments most affected by the pandemic

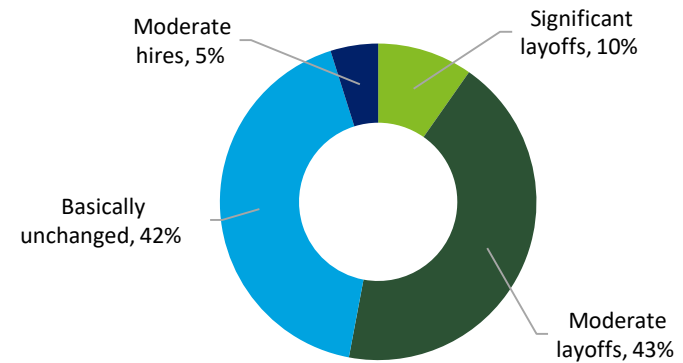


- The survey found **42%** of companies have access to essentially enough staff for their needs, 37% report an excess of staff and 21% have insufficient staff
- Staffing in most companies remained **basically unchanged** in Q1 following the outbreak. 43% of enterprises chose to lay off a moderate number of staff and only 10% of companies experienced significant retrenchments.
- Production** was the most heavily affected department, followed by Marketing/Sales. About 44% of companies say there was no major impact on management and administration

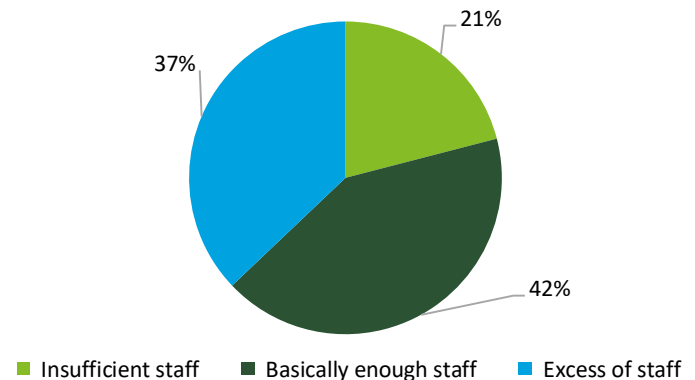
Countermeasures

- It will probably be difficult to resolve staffing issues in the short-term during the pandemic. However, businesses can consider new ways of thinking, such as **employee sharing programs** with other industries, to alleviate short-term issues. For example, e-commerce platforms such as Fresh Hema have launched staff employee sharing schemes with catering companies like Xibei. This managed to reduce wage pressures on hospitality companies partnering with Hema while providing Hema with sufficient online order delivery personnel

Q1 staffing forecasts



Current staffing needs



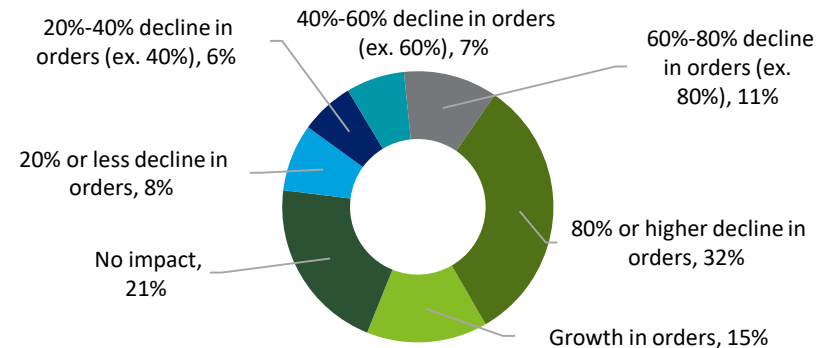
The pandemic's effect on delivery orders

- The outbreak basically shut down dine-in restaurant services. Many companies had pinned their hopes on deliveries or distribution to increase revenues, but about **32%** of respondents report a decline in delivery orders of more than 80%, around 18% report a decline of 40%-80%, and only 21% report no impact on delivery orders. A further 15% of companies say delivery orders have increased
- Catering companies still have to pay commissions to delivery platforms. **69%** of businesses say these fees are unchanged since the outbreak, about 18% report a decrease in such fees, and some 13% report an increase

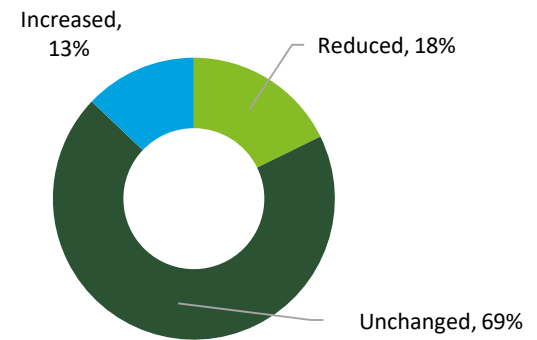
Countermeasures

- The combined impact of the pandemic on dine-in customer numbers and delivery orders has dealt a serious, negative blow to company sales. In the short-term, companies could consider methods of cross-industry **inventory sharing** via cross-industry partnerships to use up stock, e.g. with supermarkets. This might mitigate spoilage costs and grow profit margins, the liquid impacts of holding large amounts of inventory, and also serve as a countermeasure to increasing or perhaps soon to increase delivery platforms' commission take.

The pandemic's effect on deliveries



Changes to delivery platforms' commissions after the pandemic



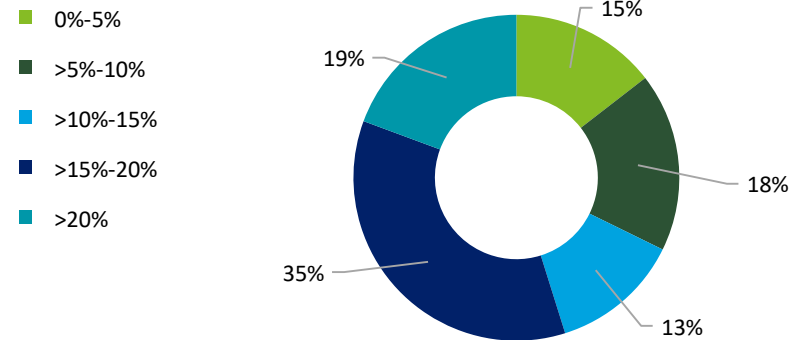
Delivery platforms' current commission and ideal range

- Companies' survey results indicate delivery platforms' current commission take is about **15%-20%**. Some 19% of respondents report a cut of over 20% and just 15% suggest a reduction of less than 5%
- Catering companies appear generally hopeful that delivery platforms' commission take may drop to **5% or less** as the situation unfolds. Around 42% of businesses declared a commission of around 5-10% a reasonable zone, but under 4% support commissions of 15% or more

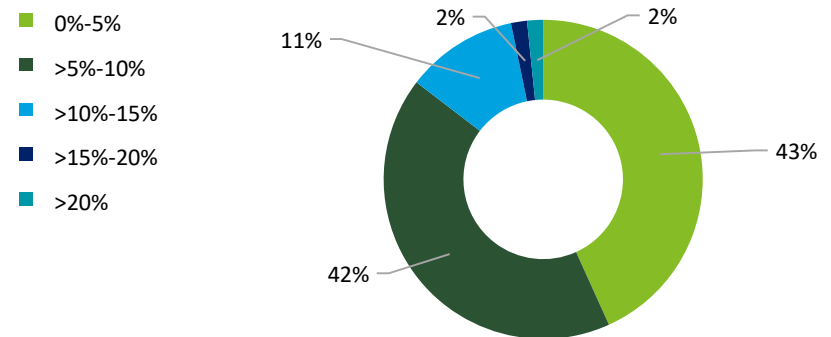
Countermeasures

- Hospitality businesses must **accelerate their transformations**. Large-scale hospitality businesses might consider establishing their own proprietary online sales and delivery systems. Doing so could reduce the squeeze on profit margins from delivery platforms' currently high commissions, **optimize cost structure**, improve operational efficiencies and service quality, and fundamentally improve competitiveness

Delivery platform commission percentage



Reasonable range of delivery platform commission



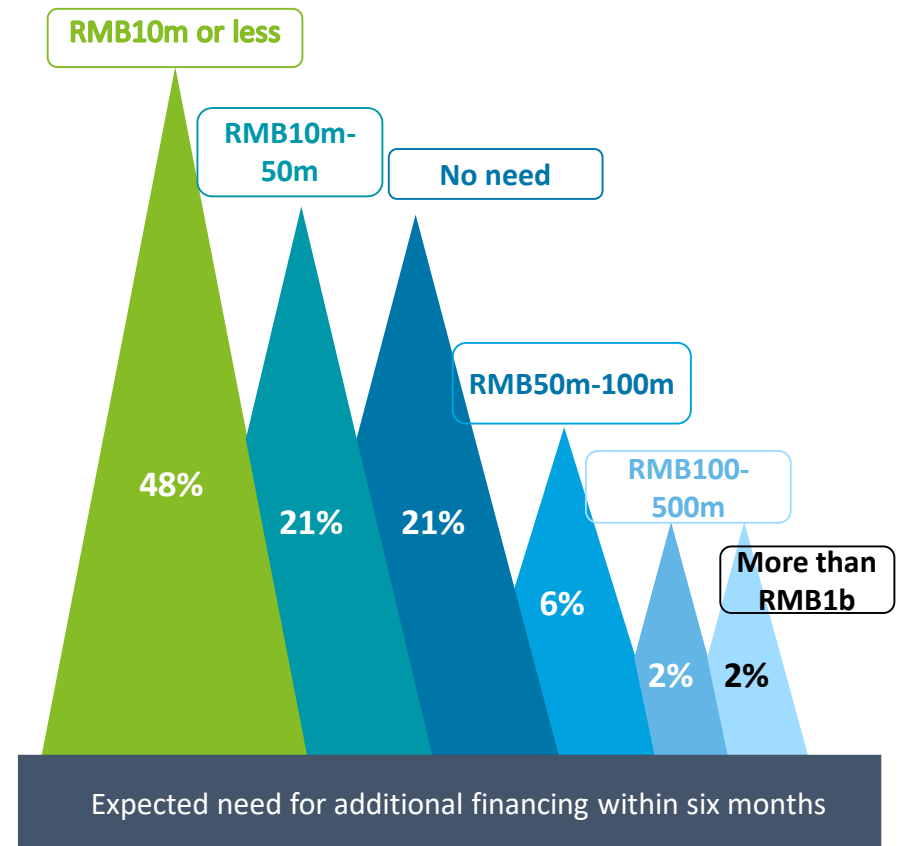
Companies' countermeasures during the pandemic

Catering companies' short-term financing needs

- Catering companies had already invested significant amounts of cash in food inventories for the Chinese New Year period and CNY bonuses. However, as an industry that is normally quite cash flow reliant, the continual unfolding of the pandemic has gradually sent many hospitality companies lurching into a cash flow gap
- The survey found about **48%** of businesses expect additional financing needs of RMB10 million RMB or less within the next 6 months, and approximately 21% anticipate needed RMB10 million-50 million. Another 21% say they have no need for additional financing or have already received financial support from existing banks or shareholders

Countermeasures

- Enterprises should look at the nature of the funding gaps in their cash flow models to determine the direction of corporate financing. Companies can consider extensions of **existing financing channels or applications for new bridge financing** to get through their current difficulties in response to **short-term funding gaps**. The strong likelihood of a substantial consumption rebound following the epidemic could well bring about a **long-term capital gap**. Companies can consider this an opportunity to add **investors of a financial or strategic nature to secure long-term funding via equity financing** to resolve cash flow problems, strengthen their capital positions, and integrate this into future strategic growth initiatives



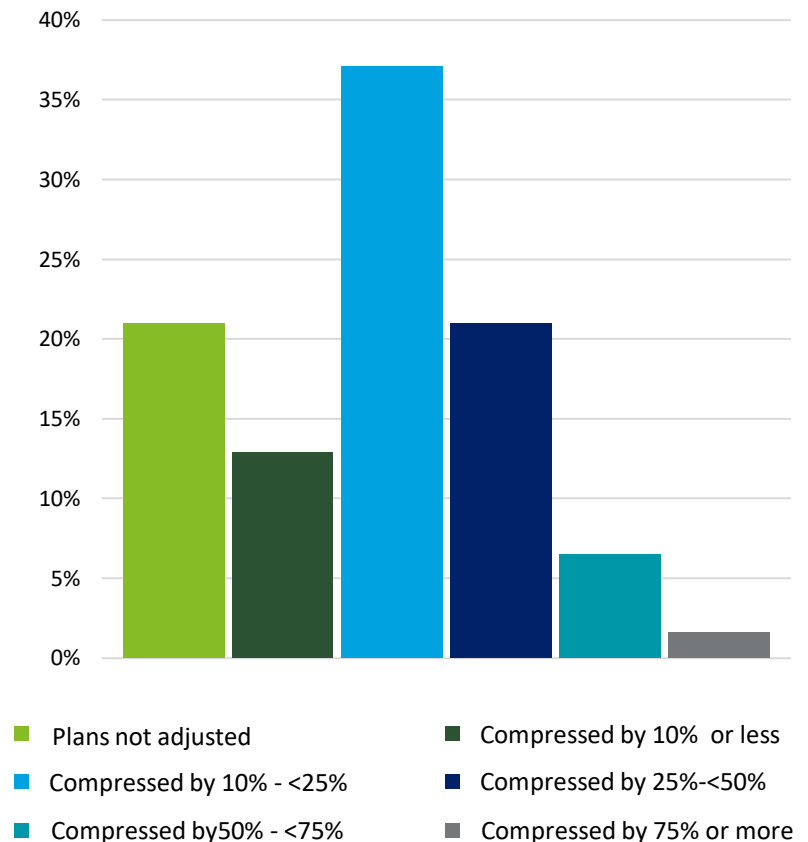
2020 budgets and financial metrics

- The survey found about 37% of businesses plan to compress their 2020 budgets and finances by 10%-25% in response to the pandemic, and about 20% plan to do so by 25%-50%, with some 20% declaring their plans unchanged
- The catering industry has **pessimistic outlook** for its 2020 finances. Social distancing and home isolation, extensions of leave and other preventative measures adopted nationwide have restricted public movement and gatherings. The hospitality industry continues to feel the effect of virtually all such activities, including group meals, wedding banquets, etc., having been brought to a halt

Countermeasures

- Catering companies are feeling the pinch on revenues to varying extents, as well as concomitant cash flow pressures due to the pandemic given upstream suppliers must also confront challenges to financial reflows. Companies should respond by quickly assessing potential funding gaps and effective countermeasures. Businesses must negotiate with existing financiers to secure current limits and fight for preferential arrangements to avoid bankruptcy should loans be called in. Companies must also **re-examine capital structures** when necessary and make full use of state-sponsored deleveraging policies; they should also seek to **optimize their proportion of debt to equity**, reduce expenditure and **optimize cost structures**

Have you adjusted your 2020 budget and financial metrics?



Measures to improve operating and financial cash flows

- About 65% of companies report initially opting to strengthen routine financial management and scheduling systems to close funding gaps. Measures open to companies to manage working capital and cash flows include:
 - **Cash flow monitoring and control:** businesses can organize cash flow forecasting templates and control mechanisms to estimate potential cash shortfalls in advance and access faster solutions
 - **Working capital management:** companies should negotiate with upstream partners as early as possible on ways to traverse these difficulties together, and can fight for extended upstream payment terms, which could even foster closer partnerships after the pandemic
- Some 58% of businesses have managed to negotiate some form of rent relief amid a broader national call on landlords to be accommodating. More than half of companies have transformed their operating models to increase sales outstanding with new product formats (e.g. the use of vacuum packaging, frozen foods and packed meals), distribution methods, etc.
- Nearly half of enterprises have opted to improve corporate cash flows through short-term wage adjustments, e.g. wage cuts or delays. Such measures to cut staff or salaries must comply with China's Labor Law as well as other laws and provisions, and professional legal advice must be sought to ensure legal compliance and reduce risks
- Larger companies facing operating and financing difficulties might want to consider employing a Chief Restructuring Officers, Restructuring Advisors or other professionals and managers, and forming special response teams to help formulate the right measures to improve operations and cash flows



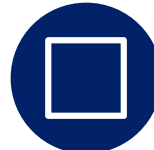
Strengthen routine financial management and scheduling systems **65%**



Negotiate rent relief with landlords **58%**



Transform operating models **48%**



Short-term reductions in wage costs **47%**



Negotiated payment extensions with suppliers **45%**

Companies' demands of government and financial institutions

Companies' preferred policy support

- The whole catering industry has been severely challenged by the pandemic. Government bodies are looking carefully at and attaching substantial importance to the industry's current conditions and demands
- The survey shows nearly 90% of companies are hoping for some form of tax relief or payment extensions from the government. 80% of companies hope the government can reduce or delay "five insurance and housing fund" payments. Over half of companies also support measures providing rent relief and/or delayed payment of wages. Companies are also hopeful of obtaining interest rate adjustments and increased medium to long-term lending from banks
- Central and local governments have released a suite of emergency support policies for SMEs, encompassing catering firms, to ride out this difficult period. Companies should pay consistent, vigilant attention to government policies as they are released and seek to **comprehensively and fully understand and utilize the support**, e.g. tax reliefs or extensions, suitable rent adjustments, social insurance rebates or payment extensions and other such favorable policies, as well as proactively engage with government institutions to acquire more support



Reduction or delay in tax payments

86%



Reduction or moratorium on "five insurance and housing fund" payments

77%



Post-outbreak rent reductions or relief

68%



Negotiating delayed wage payment with staff

52%



Reduced interest rates

50%



More medium to long-term bank lending

35%

Conclusion

The COVID-19 pandemic is having a considerable negative impact on China's catering industry in the short term, but this challenge can also be viewed as an opportunity for businesses to take advantage of new possibilities in the industry's long-term transformation.

Impact and challenges

Decline in customer numbers

- Fewer gatherings; sharp drop in customer numbers
- Increased demand for delivery and distribution
- Consumers becoming conservative

Cash flow pressures

- Rise in fixed costs, e.g. wages and rents
- Issues in financial reflows
- Sliding revenues due to declining customer numbers

Increased financing needs

- Potential tightening of supplier credit
- Insufficient short-term liquidity
- Medium to long-term recovery and growth needs

Post-pandemic period

- Consumers' increased dependence on online consumption
- Release of long-term, pent-up purchasing power
- "No man's land" after weaker competitors have been eliminated
- Spending on relatively high traffic 3rd-party platforms during online channel development

Short-term

Medium to long-term

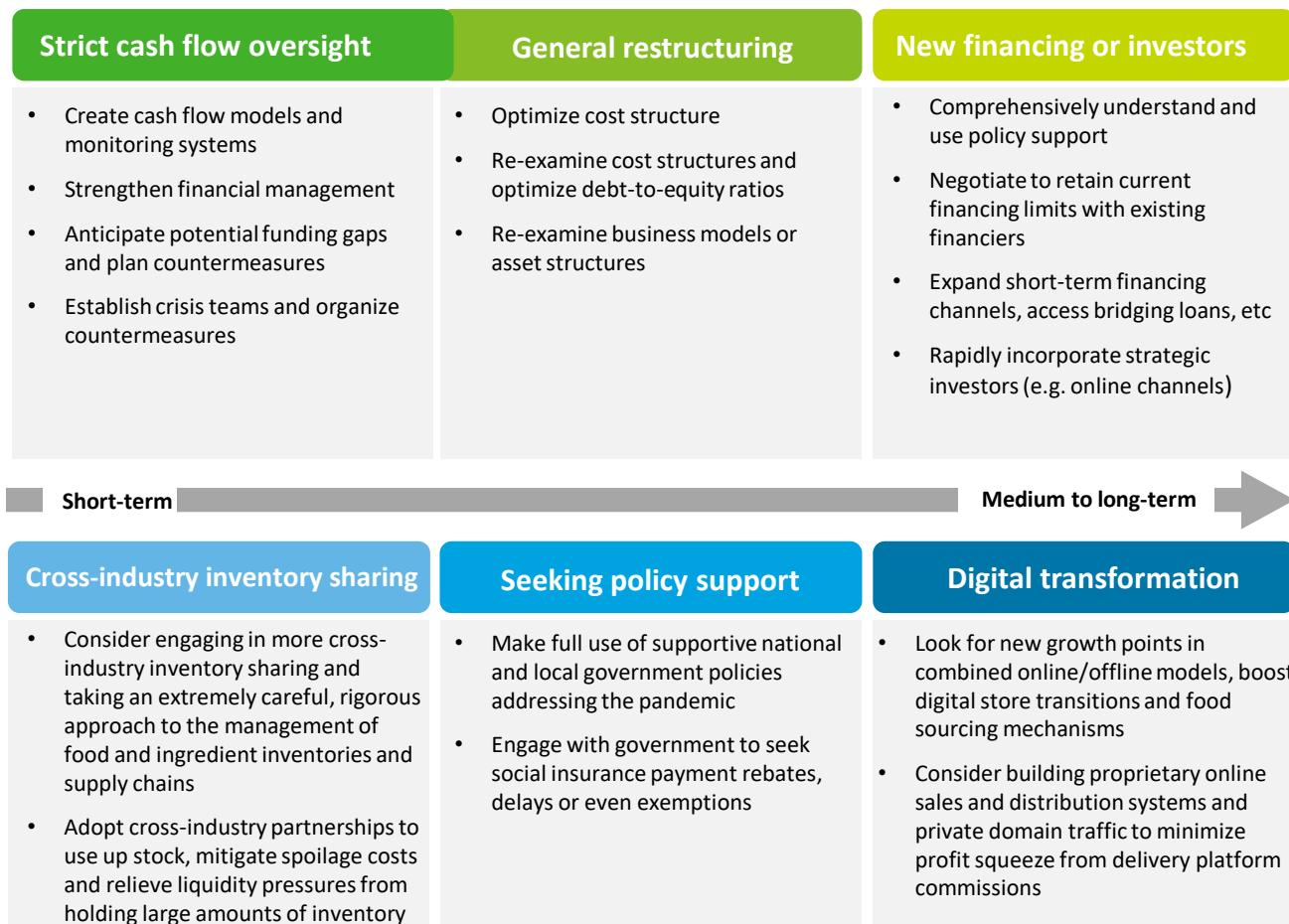


Conclusion (continued)

Opportunities

- **The catering industry's digital transition:** digitalization promises to empower the hospitality industry's supply chain and sales channels with greater business efficiency
- **The expansion of new customer acquisition channels:** expanding customer acquisition formats from traditional offline, community-based patrons and delivery platforms to more varied online channels
- **New consumption habits to inspire new models:** the hospitality industry will witness the emergence of new technologies and models to safeguard food security and improve culinary experiences, driven by new consumption needs, e.g. contactless services, personalized meals, etc.

Countermeasures



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China Cuisine Association

About the China Cuisine Association

The China Cuisine Association (or CCA) is a state-approved national guild representing China's catering industry and officially authorized by the Ministry of Civil Affairs, established in April 1987. The CCA is a voluntary national industry association of enterprises, industry organizations at all levels, social groups and individuals, including hospitality managers, professionals, scholars, chefs, service personnel etc across different areas and ownership models such as catering enterprises, hospitality management and culinary skills, dining services, food culture, education, culinary theory, and nutritional studies. The Association has been a positive force for industry organizations, self-regulation, resource consolidation, protecting the legal interests of enterprises, business coordination, international dialogue, training, etc since its founding and as supported by the government, members, and the culinary and hospitality enterprise associations of various provinces and cities. The Association has been serving society, the government, members & enterprises and playing an active and important role in promoting the industry's growth and development.



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