



Restaurant
& Catering

Competition Policy Review

Response to Issues Paper

JUNE 2014

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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EXECUTIVE SUMMARY

Restaurants, cafes and hospitality providers are an important part of Australia's economic and social fabric. Hospitality forms a critical part of the visitor economy which contributes more than \$134 billion to the economy each year. There are over 33,000 café, restaurant and takeaway businesses in Australia, contributing to 666,300 jobs, and delivering \$21.1 billion in earnings to the economy. These businesses are small businesses; with 76% of these organisations employing 19 people or less.

As a sector dominated by small business, Australian competition policy is important in protecting the interests of restaurant operators when engaged in business transactions. Restaurant, café, and catering businesses are consumers of a range of inputs from produce, to alcohol, to property arrangements, to contracts with electricity suppliers. These businesses rely on competition policy to ensure their equitable treatment in these transactions.

However, the nature of the tourism and hospitality industry is changing, resulting in shifting dynamics between restaurant operators and suppliers, landlords, and consumers. The presence of a duopoly in the alcohol distribution market squeezes supplier margins and results in higher end prices for restaurateurs. Increasing overheads and opaque provisions surrounding lease arrangements distorts market power in favour of landlords. The emergence of the digital age has also created a new marketplace in which restaurants must engage and respond to consumer feedback.

Unconscionable conduct and the burden of proof required from small business continues to be the largest issue facing small business operators in the sector. In particular, the lack of transparency around rent arrangements, predatory pricing of alcohol distributors, and an inability of businesses to respond to false negative reviews on review websites continue to be areas of concern for operators.

R&CA is seeking a clear definition of 'unconscionable conduct', providing a lesser test so small businesses can prosecute proven cases in a court of law. In addition, a Code of Conduct must be established to guide the use and operation of review websites.

Any reform agenda as a result of the review must take place with appropriate consultation with industry and mechanisms to affect change on legislation. Past industry experience with single-component pricing proved reform to be slow, bureaucratic, and unresponsive to needs of the sector.

RECOMMENDATIONS

OBJECTIVES, STRUCTURE & LEGAL FRAMEWORK

Online Review websites

- Convene an Industry Roundtable to address the lack of protocol surrounding false negative and misleading reviews on review websites and portals.
- Develop of Code of Conduct for the use and operation of review websites in line with recommendations of the *Suppliers Guide: Online reviews - a guide for business and review platforms*.

UNILATERAL CONDUCT

Predatory pricing of alcohol distributors and unconscionable conduct in rent arrangements

- Provide a clear definition of what constitutes 'unconscionable conduct', providing a lesser test so as the burden of proof is not such that small businesses cannot prosecute their case.

DISPUTE RESOLUTION & PRIVATE ENFORCEMENT

Small business engagement with the ACCC

- Further strengthen the capacity of the ACCC to investigate and take action against businesses deemed to be engaging in unconscionable conduct.
- Ensure a greater customer-service focus by the ACCC when responding to small business enquiries, including establishing KPIs for response times and referrals for questions that cannot be answered directly by the agency.

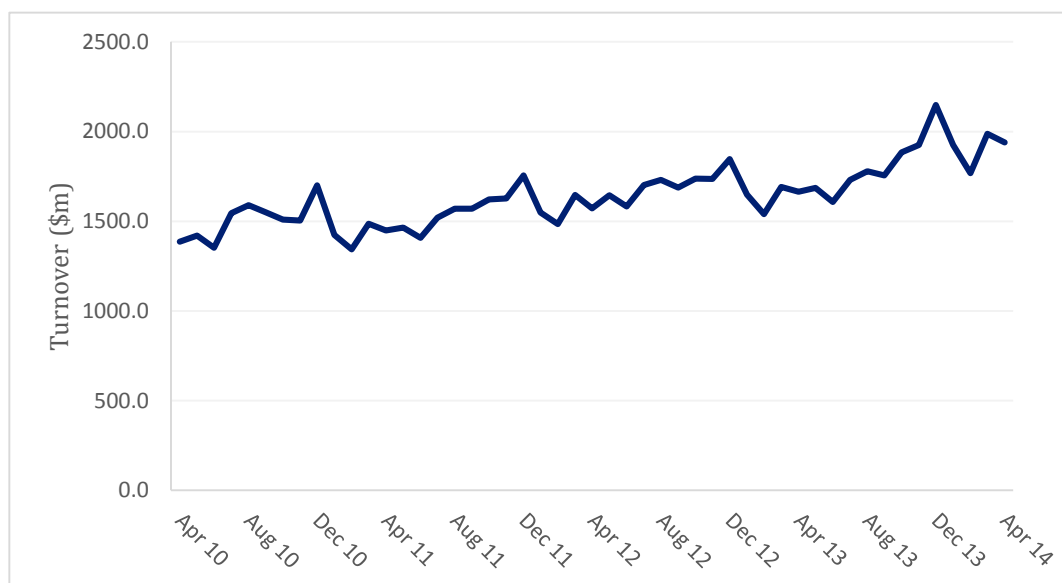
VALUE OF TOURISM AND HOSPITALITY

THE VISITOR ECONOMY

The café, restaurant, and food services sector forms a critical component of the tourism industry, and more importantly, the Australian economy. Consumption across the broader tourism and hospitality sector totalled \$134 billion in 2012-13¹. Deloitte's *Positioning for Prosperity? Catching the next wave* report highlights that tourism will be one of the major growth drivers from now to 2033, with this sector to grow more than 10% faster than global gross domestic product².

The café, restaurant and catering services sector is the largest contributor to the tourism sector in terms of employment, and the second largest in terms of tourism consumption³. Cafés, restaurants, and catering services contributed \$22.1 billion in earnings to the national economy⁴ (See Figure 1), of which \$16.7 billion is attributed directly to the visitor economy⁵.

Figure 1: Café, Restaurant and Catering services Turnover to April 2014



¹ Tourism Research Australia (TRA), *Tourism Satellite Account 2011-12*, p.vi; ABS (2013) *8501.0 Retail Trade Australia*

² Deloitte (2013) *Positioning for prosperity? Catching the next wave* October Preview 2013

³ Tourism Research Australia (TRA), *State Tourism Satellite Account 2012-13*

⁴ Australian Bureau of Statistics (ABS), *8501.0 Retail Trade Australia, Cafes, Restaurant & Catering Services*, year ending April 2014

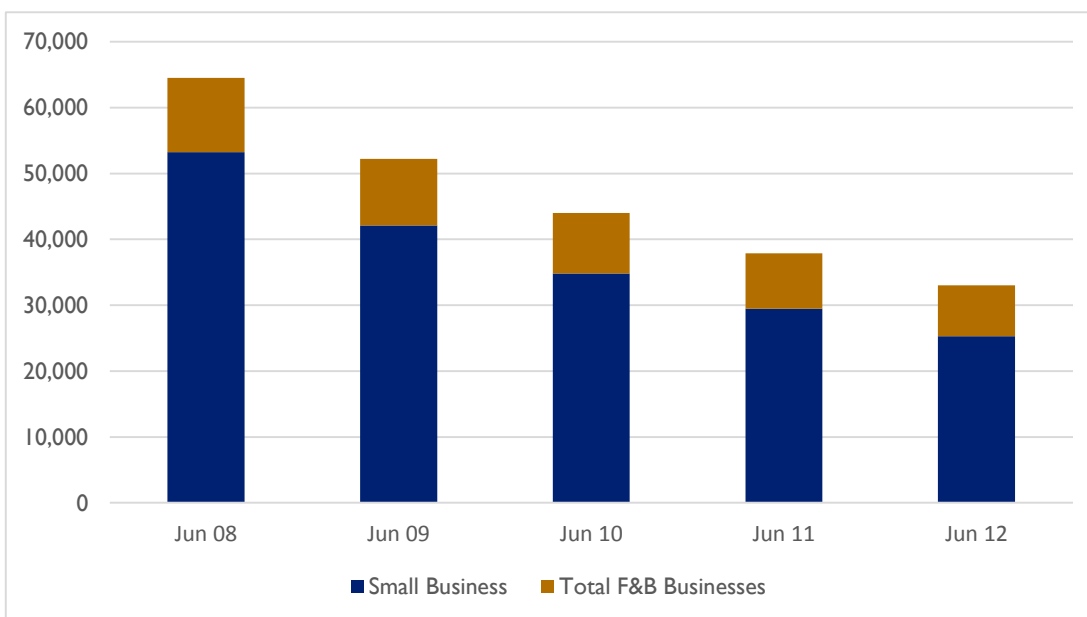
⁵ Tourism Research Australia (TRA), *State Tourism Satellite Account 2012-13*; p.38

SMALL BUSINESS IS BIG BUSINESS

The exact number of café, restaurant and catering businesses in Australia is difficult to determine due to business count reporting methods used by the Australian Bureau of Statistics (ABS). However, data commissioned by R&CA from the ABS in 2004 found 37,699 restaurant, café, and catering businesses registered for GST⁶. Of these businesses, 89% employ 20 people or less.

More recent data reveals there were 33,000 food and beverage services businesses in Australia⁷. Of these businesses, 76% are small businesses, employing 19 people or less. The food and beverage sector is the largest employer of all tourism-related sectors, employing approximately 666,300 people⁸. Since 2008, however, the number of food and beverage service businesses has been in a state of decline (See Figure 2). Increasing cost pressures, tougher operating environments, and changing consumer preferences are all contributing factors to declining operator numbers.

Figure 2: Survival of Food & Beverage businesses in Australia



⁶ Australian Bureau of Statistics (2004) Business Register, unpublished data purchased by R&CA

⁷ Australian Bureau of Statistics (ABS), *81650 Count of Australian Businesses*, including entries and exits, June 2008 - 2012

⁸ Australian Bureau of Statistics (ABS), *81550 Australian Industry 2011-12*

PRICES IN THE RESTAURANT INDUSTRY

While the sector has seen incremental growth in turnover (See Figure 1), the price of restaurant meals has not kept pace the cost of goods and services. In the March Quarter 2014, restaurant meal prices increased by 1.7 per cent. Over the same period, the price of food inputs to restaurants rose by and estimated 2.8 per cent (based on a combination of food inputs including Dairy, Meat and Seafood, Bread and Cereal, and Vegetables). In addition, the price of alcoholic beverages increased by 3.1 per cent, with the largest increases seen in spirits (4.3 per cent), beer (2.9 per cent) and wine (2.7 per cent). Trends such as these place additional pressure on restaurant operator margins.

OPERATING ENVIRONMENT OF RESTAURANTS

The food services industry is a complex and dynamic sector, often providing a barometer for consumer sentiment and economic activity. The growing popularity of shows such as MasterChef and My Kitchen Rules continue to build momentum and demand for restaurant and café experiences. In addition, food and wine has become an increasingly important component of our selling proposition to international visitors. Research indicates Australia ranks second only to France for food and wine experiences by visitors to the country⁹.

While recent improvements in consumer sentiment has seen a steady increase in restaurant turnover, diminishing business margins through cost pressures continue to increase the number of business closures. Three of the biggest trends affecting restaurant operators are outlined below:

CHANGING CONSUMER TASTES AND PREFERENCES

While restaurant meal prices continue to be outstripped by the cost of goods and services, consumer preferences for restaurant meals is also changing. While on average consumers dine out 2.5 times per week, the yield generated by these occasions continues to diminish. Data from the *Dimmi Australian Dining Index 2013* highlights the average spend per meal has decreased from \$61 to \$54. This is supported by research conducted by Foodservice Suppliers Association Australia that found the average spend per person is \$57 (\$46 food component, \$11 alcohol component)¹⁰. Consumers are moving to more informal dining options, with a preference for one-course meals at lunch and two-course meals at dinner, replacing the traditional three-course meal.

INCREASING BUSINESS OVERHEADS

R&CA's 2014 Benchmarking Survey found considerable increases in business costs and overheads associated with running a business. Staff wages and on-costs continue to be the single largest business expense for restaurant operators, representing approximately 45.3 per cent of business costs. Rent now accounts for approximately 9 per cent of business costs, up from 6 per cent in 2013. In addition, beverage cost of sales equates to around 30.7 per cent of business expenses. Uncompetitive trade practices or imbalances in the bargaining power between suppliers and small business operators in these two areas continue to significantly affect hospitality business expenses.

⁹ Tourism Australia (2013) *Gourmet Tourism is Growing*

¹⁰ Foodservice Suppliers Association Australia (2012) *Dining Out Study May 2012*

TECHNOLOGICAL ADVANCES CREATE NEW MARKETPLACES

Technological advances are changing the way restaurant experiences are shared. In 2013, 22 million restaurant searches were conducted online¹¹, with this number expected to only increase. Programs such as Tourism Australia's *Restaurant Australia* continue to drive demand for Australian food and wine experiences through social media. Social media and the internet are creating new marketplaces in which restaurants conduct their business. For small operators unfamiliar with social media, the process of monitoring and responding to publicity surrounding their business can be time consuming and challenging.

¹¹ Dimmi Australian Dining Index 2013

OBJECTIVES, STRUCTURE & LEGAL FRAMEWORK

Current competition laws and objectives of the Act remain sound in protecting the interests of consumers and to some extent small business operators.

However, the emergence of new technology has created a new marketplace in which restaurants operate and engage with consumers. Consumers are now able to freely share and communicate the experiences they have had with businesses. However, competition policy has not kept pace with these developments, with minimal parameters to guide the conduct of review websites and the use of these sites by consumers, for example.

ONLINE REVIEW WEBSITES

Online review websites are becoming a critical component of the consumer decision making process in the tourism and hospitality industry. The *Dimmi Australian Dining Index 2013* found that 22 million restaurant searches are completed online each year, generating \$120 million in incremental value to the sector. Consumers now use websites such as TripAdvisor, UrbanSpoon and Eatability to guide their dining decisions. While these websites can improve the profile of restaurants with consumers, they can also impact the takings and reputation of an establishment if claims are false or misleading.

Many restaurant operators concede that negative reviews will occur; however 'false negative' reviews posted by disgruntled customers, employees, competitors, or friends of patrons, can have a detrimental impact on small business operators. Research commissioned by R&CA on the impact of false negative reviews found that 61 per cent of restaurants agreed that negative online reviews are used by customers when choosing restaurants or catering businesses, with 56 per cent of restaurants agreeing that negative online reviews deter people from dining at a restaurant or using a catering business. In addition, 60 per cent of restaurant businesses strongly agreed that negative reviews hurt the reputation/brand of a restaurant or business¹².

R&CA members report a lack of protocol by online review sites in handling restaurant complaints about potential false negative reviews on their sites. Concerns are met with minimal impetus to investigate the issue, despite the review having detrimental impacts on restaurant patronage and sales. In addition, the action taken by review websites in relation to false negative and false positive reviews is inconsistent and poorly documented, with members reporting sites removing reviews they deem 'too positive', yet refusing to investigate reviews that restaurants believe to be false or grossly

¹² Griffith University (2013) *Restaurant Online Review Study, December 2013*

misleading. As a result, restaurant owners have begun to police comments themselves taking time and focus away from their business.

While R&CA acknowledges the development of the Australian Competition & Consumer Commission's (ACCC) *Suppliers Guide: Online reviews - a guide for business and review platforms*, the association believes these guidelines do not go far enough in providing restaurants with protection against false negative reviews. R&CA research found that 76 per cent of restaurants strongly agree online reviews should be more tightly regulated and 55 per cent strongly agree negative online reviews are something the industry needs help addressing¹³.

The guidelines provide no enforcement powers to the ACCC to investigate issues of misuse, nor directs the sites themselves to put in place simple measures to address issues of false reviews including:

- Providing restaurant owners with the right of reply when a negative review is posted;
- Making the user reveal their identity when making a post; and
- Ensuring that the customer has indeed dined at this establishment by including the date and time of their experience.

Given there is no code of conduct that guides the operation and use of these sites, an imbalance of power occurs between businesses and consumers.

Recommendation

- Convene an Industry Roundtable to address the lack of protocol surrounding false negative and misleading reviews on review websites and portals.
- Develop of Code of Conduct for the use and operation of review websites in line with recommendations of the *Suppliers Guide: Online reviews - a guide for business and review platforms*.

¹³ Griffith University (2013) *Restaurant Online Review Study, December 2013*

UNILATERAL CONDUCT

Unconscionable conduct is one of the biggest issues affecting small business operators in the tourism and hospitality sector. These businesses often engage in multiple transactions with large-scale suppliers and producers to source good and services. R&CA has outlined below two key examples of unconscionable conduct pertaining to the operation of hospitality businesses; namely predatory pricing activities of alcohol distributors and rent arrangements with landlords.

PREDATORY PRICING OF ALCOHOL DISTRIBUTERS

Australia's alcohol market is dominated by two large retailers, namely Westfarmers (Coles) and Woolworths. This duopoly has changed the structure of the industry, reducing the profitability of liquor suppliers, and in turn placing upward pressure on prices paid by restaurant operators for alcoholic beverages.

Industry analysis completed by the Australia Institute indicates that the considerable market power of Coles and Woolworths has resulted in smaller alcohol retailers being squeezed out of the market, at the same time these retailers are able to place downward price pressure on liquor suppliers by negotiating tougher distribution deals. In addition, these retailers threaten established brands through the introduction of 'home brands' in the market¹⁴. This is particularly true for wine, where the industry is characterised by a larger number of Australian producers, as opposed to the beer industry which is dominated by two large producers, Lion and Carlton & United Breweries (Foster's)¹⁵.

As a result of these practices, wine producers are forced to sell at below cost to Coles and Woolworths, reducing their margins. Stocking fees charged by these retailers also further reduce supplier margins. Consequently, wine producers seek to recoup the loss of their margins by inflating on-premise prices paid by restaurant operators who buy direct, resulting in higher beverage cost of sales for these operators.

Beverage cost of sales already represent a significant proportion of restaurant expenses. R&CA's 2014 Benchmarking Survey found that beverage cost of sales represent 30.7 per cent of business expenses, an increase from 28.1 per cent recorded in 2012-12.

¹⁴ The Australia Institute (2012) *The Liquor Industry* Technical Brief No. 14 ISSN 1836-9014

¹⁵ The Australia Institute (2012) *The Liquor Industry* Technical Brief No. 14 ISSN 1836-9014

In a bid to contain cost pressures arising from this market imbalance, restaurateurs are resorting to purchasing alcohol from Coles and Woolworths as opposed to wine producers directly.

In this sense, Section 46 of the Competition and Consumer Act has failed to address the imbalance of market power in the alcohol market which in turn is having an adverse effect on operator margins and prices in the tourism and hospitality industry.

UNCONSCIONABLE CONDUCT IN RENT ARRANGEMENTS

An overwhelming number of restaurant businesses rent their place of operation. R&CA's 2014 Benchmarking Survey found that 87.5 per cent of restaurants lease their place of operation. In determining lease arrangements, a majority of businesses indicate rent reviews are based on CPI increases (57.9 per cent), market review (19.8 per cent) or a mix of both (13.2 per cent). However, 9.1 per cent of businesses indicated rent reviews are determined based on turnover data.

Landlord to tenant unconscionable conduct is one of the most common issues raised by members of the association. R&CA members perceive a significant imbalance in the bargaining power between landlord and tenant, particularly with larger shopping centres. The imbalance often results from the additional investment restaurant owners make above and beyond rent paid, including funds contributed to fit out, marketing, and the generation of goodwill. This means that at the time of lease renegotiation, it can sometimes be more critical for the operator to re-secure the lease than the landlord.

Turnover data is an area of considerable contention for restaurant owners. The ability of landlords to request turnover data and make decisions based on this information results in inequity for operators in the decision making process. There is no transparency in how this information is used across multiple tenant arrangements, particularly in larger shopping centres. Rarely do landlords grant struggling tenants rent concessions following a review of turnover data, yet rents are revised upwards based on favorable earnings recorded.

Furthermore, the disclosure of turnover data does not allow operators to balance leasing costs over the life of a lease, which is often necessary given the cyclical nature of the hospitality industry. Operators require certainty of tenure in order to operate their businesses effectively. This, coupled with the capacity for landlords to increase rent based on turnover data can create considerable uncertainty as to a restaurant's operating environment.

R&CA understands issues pertaining to lease arrangements are subject to the respective Acts in each state, to which R&CA has made submission (notably the 2013 Review of the *NSW Retail Leases Act 1994*). However, the association believes there is a role in competition policy to address the abuse of market power in determining rent arrangements with small businesses, and advocates that the collection of turnover data should not be required or used in the determination of lease arrangements.

Recommendation

- Provide a clear definition of what constitutes ‘unconscionable conduct’, providing a lesser test so as the burden of proof is not such that small businesses cannot prosecute their case.

DISPUTE RESOLUTION & PRIVATE ENFORCEMENT

BUSINESS ENGAGEMENT WITH THE ACCC

Most small businesses have minimal understanding of their rights with regards to competition policy, or the mechanisms in place to provide businesses with support and assistance. Small businesses find it extremely difficult to ascertain whether unconscionable conduct has indeed occurred, and whether there are grounds to take action. The advisory system is hard to navigate, advice varied, and the cost of taking action often exceeds the value of the business owner's time and resources required to mount a case.

R&CA welcomes the announcement of an additional \$1.4 million to the ACCC to support the extension of unfair contract term provisions to small businesses. This initiative will go some way in providing small businesses with greater protection when entering into agreements with suppliers and producers.

However, the extension of these provisions must be met with the appropriate agency structures and resources to prosecute and investigate misconduct. The ACCC is often seen as inaccessible to small business. Whether it be in relation to unconscionable conduct or other matters in which small businesses experience duress at the hands of larger businesses, operators report finding it difficult to deal with the ACCC.

INDUSTRY CASE STUDY: Single-component pricing

R&CA has experienced first-hand the process required to affect change on competition policy inadvertently impacting restaurant operators.

Changes to single-component pricing in 2009 resulted in restaurant operators being required to print separate menus for days where surcharges applied to restaurant meals. The requirements resulted in inefficiencies and additional costs as businesses had to constantly print and change menus. Minimal education was provided to operators on the implementation of the changes, resulting in significant fines and confusion in the sector.

The process of engaging government and the relevant agencies on the issue was slow and cumbersome, with the response to industry concerns poor and uncoordinated.

As a result, it took R&CA four and a half years to affect change and have restaurants exempt from single-component pricing.

A greater customer-service approach is required by the ACCC when dealing with small businesses that contact the agency. The ACCC needs to be more responsive to enquiries from small business, ensuring response times to enquiries are subject to KPIs. Referrals should also be established where questions cannot be answered.

In addition, R&CA would encourage that any reform agenda resulting from the competition review needs to be approached transparently, with appropriate consultation with key industry stakeholders. Review mechanisms must be in place to address anomalies in the system that can unintentionally affect industry operators, particularly small business.

Recommendation

- Further strengthen the capacity of the ACCC to investigate and take action against businesses deemed to be engaging in unconscionable conduct.
- Ensure a greater customer-service focus by the ACCC when responding to small business enquiries, including establishing KPIs for response times and referrals for questions that cannot be answered directly by the agency.

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