

Research on the development of Chinese start-up catering enterprises

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Abstract: China's catering market is large, and there is also a lot of research on Chinese catering enterprises, but many studies ignore the growth and development factors of start-up catering enterprises. This paper studies the start-up catering enterprises in China, based on the big data of catering over the years, and expounds on the problems and opportunities encountered in the development of start-up catering enterprises from three aspects of commercial real estate market, capital market and product positioning.

Key words: Start-up catering enterprises, Commercial real estate, Capital market, Product positioning

1. Introduction

The main content of the catering industry is that the organizations (such as restaurants, hotels, food processing plants) or individuals engaged in the industry can meet the eating and drinking needs of consumers and obtain corresponding service payment from the industry through the processing of the food and drinks. Due to the different habits and tastes of different groups in different regions and different cultures, catering around the world shows diversified characteristics. The catering industry is an early open industry in China. China's catering market is huge and has been growing healthily. The market scale has increased from 2.9 trillion in 2014 to 4.7 trillion in 2019, with a compound annual growth rate (CARG) of 10.1%. Although due to the impact of the epidemic, the scale of the catering market will decline by 15.4% to 4.0 trillion yuan in 2020, it is expected that under the premise of China's macroeconomic slowdown, the growth rate of China's catering revenue will remain between 8.0% and 9.0% from 2020 to 2026, and the catering revenue is expected to reach about 8.2 trillion yuan by 2026.

However, from January to May 2021, the turnover of Chinese catering companies grew by 13.2%, the lowest level in nearly a decade. The current growth rate of China's catering industry is far from the Ministry of Commerce's forecast of catering development during the 12th Five-Year Plan period (16%). For example, Haidilao, China's first catering brand, will close 300 stores due to poor performance; Cha Yan Yue Se, a famous milk tea brand that monopolized Changsha milk tea market, will also temporarily close 80 stores; The number of Xiabu Xiabu restaurant chain in China's core cities such as Beijing, Shanghai, Guangzhou and Shenzhen has shrunk by half, and the western-food chain called New Element with more than 30 direct stores will be all closed in 2022. The continuous closure of well-known chain catering enterprises in China shows that in the background of the booming overall market of the catering industry, there are still many risks and traps. The success rate of opening restaurants should always be the focus of catering enterprises. However, China's well-known chain catering enterprises are still deep in the tide of store closures, and for the start-up catering enterprises, it is even more dangerous and difficult to enter the industry.

At present, in the catering industry, the government

departments, academic research institutions or industry consulting institutions usually do research only focusing on well-known chain catering brands and star enterprises, ignoring the research on start-up catering enterprises. The purpose of this paper is to analyze the various risks and crises existing in the growth process of start-up catering enterprises. And propose the corresponding solutions in the following three aspects: 1) Commercial real estate market. 2) capital market. 3) product positioning.

Methods:

The success of a start-up catering enterprise is most closely related to the three aspects: commercial real estate, capital market and product positioning.

1.1 Commercial real estate:

Commercial real estate is a broad concept, for catering enterprises, its core is the geographical location and rent level. The catering industry is highly dependent on commercial real estate and closely linked to the real estate market. Geographic location is the most important part of the catering industry. In terms of the location of chain restaurants in China, we mainly consider two types of geographical locations: one is the mature shopping mall, and the other is the street frontage location in mature areas.

1.1.1 In a mature shopping mall:

SWOT analysis of start-up catering enterprises in shopping malls:

Strength:

- Start-up catering companies are highly motivated and make quick decisions

- They are more optimistic about the future

Weakness:

- Low in the start-up catering enterprise brand awareness
- Entrepreneurial experience is relatively insufficient
- Market information grasp is insufficient, and the risk of information asymmetry intensifies

Opportunity:

- China's catering market is huge and has a broad prospect
- Start-up catering enterprises are often choosing the relatively blank market or unique products

Threats:

- Rent and price discrimination in shopping malls
- Mall rental location discrimination

- Fierce competition among well-known catering brands

According to the Nelson (1958) rule: “Retail business cumulative gravity theory and complementarity law (the rule of retail compatibility)”, the business volume of a store is divided into the following three forms:

(1) Famous brand attraction type (Generative business)

The business is obtained through the merchant’s own business efforts. The store’s own commodity positioning, service management and publicity and promotion will have an impact on its own business. As the core engine and main tenant of the shopping center, the main store has high popularity, high brand effect, good reputation and strong customer collection ability.

(2) Customer source-sharing type (Shared business)

It refers to the business volume obtained due to the customer collection capacity of adjacent stores. Consumers are mainly attracted by nearby stores and come to the store to consume.

(3) Induced impulse type (Suscipient business)

It refers to the impulsive consumption of consumers who come to the store for shopping due to the attraction of a certain feature of goods when they engage in other activities.

Under normal circumstances, the start-up catering enterprises in the shopping mall belong to the customer source-sharing type and need to rely on other famous brand attractive stores. This is likely to suffer from congenital rental price discrimination and rental location discrimination. In terms of brand-introducing strategy, when shopping malls introduce brands, well-known and famous brands in line with the positioning of the shopping malls will be given great rent concessions and the most eye-catching locations. Shopping malls even pay huge costs for them such as decoration in order to make sure these brands will come in. And these preferential rent and decoration fees paid are all transferred to the customer source-sharing start-up catering enterprises. That is the rental price discrimination. The location left for start-up catering enterprises is also a relatively remote location with less passenger flow, which is the rental location discrimination.

Take Haidilao, China’s largest restaurant chain brand, as an example. Its rent cost accounts for only 4%. What is more, many shopping malls are willing to pay huge decoration fees for this brand. The shopping mall cannot receive any rent from Haidilao but spend huge expenses, so they need to get more money from other small catering enterprises to keep the balance. This creates a common phenomenon: when start-up restaurants enter shopping malls, they often find themselves in poor locations with less passenger flow, but the rent is much more expensive than other well-known brands.

Generally speaking, there are many discrimination and commercial traps in shopping malls, and it is not suitable for start-up catering enterprises to set up stores in shopping malls at the beginning.

1.1.2 The street frontage location in mature areas:

To get such a location mainly depends on the brand influence and entering into the areas earlier than others.

Take KFC and McDonald’s for examples, they entered China in the 80s and 90s of the last century, with the lower rent, first occupied China’s famous business circle and the best street frontage locations, and generally signed 20 years leases. And most lease agreements were also exclusive, and the landlords did not allow the introduction of the same category of catering enterprises in the same business circle. As of June 2020, the number of KFC stores in

China had reached more than 6,000, and McDonald’s also had more than 3,000. They basically occupy prominent street-facing locations in the mainstream business districts of major cities in China. This strategic advantage, on the one hand, benefits from the influence of KFC and McDonald’s international famous brands. On the other hand, it is also because they entered the Chinese market earlier and expanded rapidly with the rapid growth of China’s commercial real estate market. This strategic advantage has innate exclusivity. It is difficult for competitors in the same business circle to find an ideal location and compete with it.

The opposite example is Burger King. By June 2020, Burger King had 17,000 stores worldwide, higher than KFC’s 15,000 stores. But Burger king had fewer stores in China, with only about 1,300. The core reason is that Burger King only entered China in the early 2000s, 20 years behind KFC. China’s major cities have long been occupied by KFC and McDonald’s. In the past 30 years, China’s commercial real estate market had developed rapidly, rents had soared, and the cost of renting and opening stores had increased significantly. So it seriously hindered burger King’s development speed in China.

Well-known international brands such as Burger King have faced strong development obstacles due to their late entry. For start-up catering companies, it is difficult to develop stores in the mainstream business districts of major cities in China in modern days.

1.2 Capital market

In the past many years, the number of catering enterprises listed has been in the single digits. But in recent years, the capital market particularly favors catering enterprises. In just one month, the number of IPO enterprises is more than ten years. Since July 2021, investment in the catering industry has become more popular. On July 13, HEYTEA Tea was revealed that officially completed 500 million dollars financing, a valuation of 60 billion yuan. On July 14, Yu Jian noodle completed new financing of 100 million yuan, a valuation of 3 billion yuan. On that afternoon, Bao Shi Fu completed a new round of financing, a valuation of 10 billion yuan. Previously, ramen noodles, brine vegetables, grilled skewers and other categories of food enterprises have obtained tens of millions or more than hundreds of millions of financings.

According to the 2021 China Chain Catering Industry Report, the average investment in the catering industry in 2021 reached 361 million yuan, nearly 14 times of 10 years ago. There are 374 investment and financing events in the food field, accounting for 45% of the total new consumption sector, ranking No.1. The total financing amount also reached 43.1 billion yuan, accounting for 52% of the total new consumption field. The report also pointed out that with the emergence of more and more single high amounts of investment, in the next five years, many catering companies with a net profit of tens of millions of yuan or even hundreds of millions of yuan will complete the listing. The catering industry may lead to a wave of IPO trends in the consumer industry.

From the perspective of financing round distribution, compared with 2019, the most important feature of investment and financing in the catering industry in 2020 and 2021 is that the proportion of B round, strategic investments and other later investments increased significantly; the proportion of early investment such as Pre-A round and A round decreased. From the subdivision of the track, ranked by the number of financings, the three tracks of snack

fast food, coffee and tea are the most sought after by the primary market. In terms of the financing amount, tea drinks, coffee and hot pot accounted for 40.5%, 15.7% and 13.1% of the industry's financing amount from January to July, respectively.

The favor of the capital market for the catering industry makes the catering chain brands have a rapid development. But for the catering industry, it is likely to have a negative impact. As a traditional industry, the development of the catering industry has its own objective laws. The traditional catering industry is driven by cost & profit, and whether a single store is profitable is the first important position. If the restaurant cost is high, the profit is small or even a loss, then the restaurant is of little value. However, the value of catering enterprises in the capital market is not measured by the traditional cost & profit accounting, but by the future valuation of the number of stores, instead of paying attention to the quality of a single store. In other words, no matter how high the rent is, it can attract venture capital in the capital market as long as there are enough stores. Brand catering and star catering enterprises in the support of capital, regardless of the cost, are crazy to open new stores no matter how high the rent is and no matter whether it can be profitable. They also use the influence and information network of capital to enter the core locations of the mall or take the street frontage locations for rent higher than the market price. But as a start-up catering company, the investment money is often self-raised funds and the budget is very limited. Without venture capital, start-up catering companies cannot afford such a high rent or compete with other well-funded catering companies with venture capital. And because the information network is weak, it is impossible to obtain the core location of the mall, so it is in a very unfavorable competitive position.

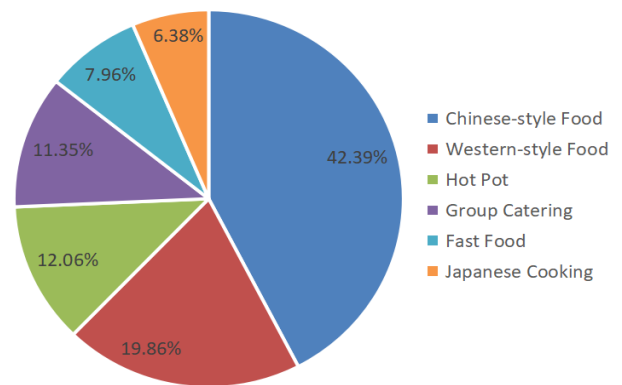
While some brand catering and star catering enterprises grow savagely with the help of venture capital, on the other hand, in the past 2021, hundreds of thousands of restaurants in each category disappeared in the catering industry. Nearly 400,000 fast-food restaurants, 100,000 hot pot restaurants and 350,000 milk tea stores closed down. So we deduce that this kind of disorderly expansion in violation of the laws of the catering industry will undoubtedly make other start-up catering enterprises certain troubles, and have a great negative impact on the start-up catering enterprises that are single-store profit-oriented. More importantly, it disrupts the order of the commercial real estate market, giving the landlords of commercial real estate an illusion that no matter how high the rent is, there will be someone who can afford it. This phenomenon will in a disguised way suppress the real entity economy, which has already been seriously impacted by online shopping.

1.3 Store product positioning

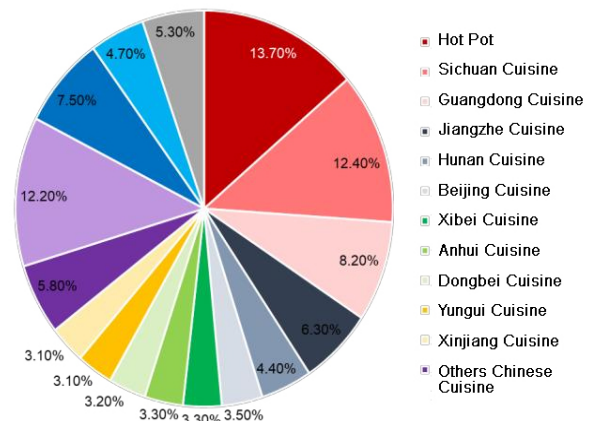
As a start-up catering enterprise, the first thing is to carry out product positioning, in a popular word in China now, it is to choose the track. Accurate product positioning can greatly increase the success rate of start-up catering enterprises. According to the survey of consumer dining factors, the top three factors that consumers are most concerned about when choosing restaurants are the taste of food, the consumption cost and the internal dining environment. The taste of dishes accounted for 71.7%, significantly higher than other elements. It can be seen that the main demand of consumers is the pursuit of taste. For start-up catering companies, finding their own unique taste positioning and planting the taste "seed" in the minds of consumers is crucial to the success of the restaurant. A clear

brand positioning can accurately explain the product characteristics, the consumer groups and other information to the whole market. When consumers come to a restaurant, if they can immediately say its characteristics and have a certain degree of recognition, that means the restaurant will have the core competitiveness.

China's catering industry has gradually changed from single catering to diversified catering, with a more accurate segmentation of business types. They are Chinese-style food, group catering, fast food, takeout, snack and western-style food, Japanese cooking, Southeast Asia and other countries' catering, which provide consumers with rich and diverse market choices. According to the report on China's chain catering industry in 2019, most of the types in China's catering industry were Chinese-style food, accounting for 42.39%, western-style food accounted for 19.86%, hot pot accounted for 12.06%, group meal accounted for 11.35%, fast food accounted for 7.96%, and Japanese cooking accounted for 6.38%.



According to the 2021 China Chain Catering Industry Report, the Chinese catering industry has rich cuisines and many consumers. Among many cuisines, hot pot is the largest market category among all Chinese restaurants accounting for 13.7%, and Sichuan cuisine ranks second among all categories. According to the data from Frost & Sullivan and Meituan-Dianping, the total revenue of the hot pot market increased in 2017 from 281.3 billion yuan in 2013 to 436.2 billion yuan (CAGR: 11.6%), and the total number of hot pot restaurants increased from 323,000 in 2017 to 520,000 in 2019, making hot pot one of the fastest-growing segments of the Chinese catering market.



According to the consumer favorite taste data of Meituan-Dianping, spicy, light and fresh are the three favorite flavors, with 41.8 percent liking spicy flavors, 23.7 percent preferring light

flavors and 20.3 percent liking fresh flavors. Spicy food is a taste jointly accepted by more consumers. The main flavor of the food is spicy flavor, which is realizing the occupation of the taste buds of most Chinese consumers. In addition, the characteristics of spicy food can stimulate unlimited demand in the existing customer group. It is often said that eating spicy food is easily addictive because eating spicy food causes the body to release endorphins, which make people feel happy. Therefore, potential customers may consume repeatedly out of periodic demand for spicy food. While in China, hot pot is the main representative of spicy food. So in general, in the case of relatively strong national demand, the hot pot market segment has a large space for expansion, and is a stable, high success rate of product positioning.

2.Result and Discussion

2.1 Commercial real estate: In terms of geographical location and rent level, start-up catering enterprises suffer from great price discrimination and have no advantage at all. Therefore, as the founders of start-up catering enterprises, they need to find other potential opportunities in the blue ocean, which means in less competitive business circles and shopping malls, instead of confronting the superior forces of competitors in the Red Sea.

2.2 Capital market: Start-up catering enterprises need to attract venture capital and accelerate growth and expansion. However, if the financing is failed and their self-raised money is insufficient, they will be strongly challenged by competitors who have obtained venture capital, and be in a very unfavorable and difficult situation in location finding and marketing.

2.3 Product positioning: Take the hot pot as an example. Its taste is more in line with the eating habits of Chinese people. The high degree of standardization, low technical barrier and high gross margin characteristics make hot pot become the preferred category for many entrepreneurs to enter the catering. However, the strong competitiveness of hot pot star enterprises causes an obvious Matthew effect, that is, the strong are always strong, the weak are always weak, and the latecomers have a low probability of success. Moreover, hot pot is the category with the highest degree of branding among catering categories, and almost every city in China has local regional brands with obvious advantages. The whole hot pot industry has experienced fierce competition.

3.Conclusion

According to the above analysis, it can be seen that in the complex competitive environment, start-up catering enterprises do not have an advantage in commercial real estate and capital market, and suffer losses because they newly enter the catering market, and they often suffer from price discrimination. Start-up catering enterprises are full of crises and traps on the road to development.

4.Recommendation

4.1 Suggestions on the commercial real estate market: to explore emerging markets and self-owned real estate.

4.1.1 Explore emerging business districts.

According to a report on China's population and labor issues released by the Chinese Academy of Social Sciences in December 2021, China's urbanization rate is estimated to increase by an average of 1.03% per year during the 14th Five-year Plan (2021-

2025), with a target of 75% to 80% by 2035. The annual increase of the urbanization rate means that more and more new business districts are born. Just like KFC entered China 30 years ago, it is a once-in-a-lifetime opportunity for start-up catering enterprises. In the emerging business circle, investors of start-up catering enterprises can have more opportunities to show their investment vision. They can seize a favorable location before other catering giants enter and find business opportunities, so it is easier to achieve profits.

4.1.2 Self-owned real estate.

The advantages of self-owned real-estate restaurants are particularly obvious. Start-up catering enterprises no longer need to suffer from rental price discrimination and location discrimination. At the same time, they can operate in this location without worrying about the rent increase or refusal of renewal when the contract expires. In this mode, the profit of enterprises is divided into two parts, one is the profit of the restaurant itself, and the other is the appreciation of the real estate itself. Both sides contribute to a steady stream of profits. It can be said that such a restaurant is an absolutely successful restaurant, and such an investment is also an absolutely successful investment.

We know that in the United States, McDonald's is not only a catering company but also a real estate company. By the mid-1980s, among the nearly 10,000 restaurants, 60 percent of the real estate property rights were owned by McDonald's headquarters, and another 40 percent were rented from local property owners. One-third of McDonald's revenue comes from direct stores and the rest from franchise stores, while real estate accounts for 90% of total revenue. So the real estate income became the main income of McDonald's. At the same time, McDonald's has become the king of real estate in retail. In the 1990s, McDonald's owned 69% of all restaurants' real estate property rights in the United States, and 35% outside the United States.

Of course, this model isn't applicable in China. Because most of China's mature shopping malls and business circle commercial real estate are not for sale. Only a small number of emerging business districts are likely to sell a few shops. Investors in start-up restaurants can still investigate and buy a small number of available shops. Because it is a new business circle, before it develops into a mature business circle, there will not be too many people paying attention to the location of high-quality shops, so it is a good time for start-up catering enterprises to catch the opportunity. But buying and self-holding real estate property also face two problems: a. If the emerging business circle does not eventually develop into a mature business circle, then the value of the shops purchased will shrink. So this is a certain risk that testing the investors' vision and the ability to predict. b. Shops are often very expensive to buy. Although start-up catering enterprises have limited funds, they can raise money through loans and other means. Loans have interest, but the interest is always much lower than rents. The interest rate has also risen far less than rents. For all start-up enterprises, paying interest is definitely much more cost-effective than paying rent.

4.2 Capital market Suggestions

Start-up catering enterprises need to attract venture capital to improve competitiveness and achieve rapid development. The following factors for start-up restaurants determine whether they can attract venture capital:

4.2.1 The ability of the company team, especially the founders.

The founders and founder teams are always the primary indicators of venture capital institutions. The founder's vision determines the height of the enterprise, and the founder's ability determines whether the project lasts.

4.2.2 Product positioning. Good product positioning will be very popular in the market, and it will be easier to open up the market and achieve profits. The hot pot product analyzed in this paper is one typical example.

4.2.3 Whether the stores can be replicated and expanded on a large scale. As mentioned before, the value of catering enterprises in the capital market is not measured by the traditional cost & profit accounting, but by the future valuation of the number of stores. The number of stores is the main index in the capital market. Therefore, whether the store can replicate and expand rapidly is an important factor for venture capital institutions to consider.

If start-up restaurants cannot meet the above requirements, it is not easy to attract venture capital. In this case, it is necessary to avoid venture capital competitors in terms of location finding and marketing and so on. Because such competitors have strong financial strength, willing to spend money, regardless of the cost, be crazy to open new stores no matter how high the rent is and no matter whether it can be profitable. Start-up catering enterprises cannot be compared with it and is difficult to compete with them.

4.3 Product positioning Suggestions

Hot pot is a highly standardized product that does not depend on the cooking skills of the chef. Although hot pot is classified as Chinese dinner, it is essentially a semi self-service, providing standardized processed ingredients and soup bottoms, which is most suitable for chain operation. Hot pot is also the category with the best standardization and the strongest profitability among the dinner categories. It is a priority for entrepreneurs with certain financial strength and operation ability.

At the same time, with the explosive growth of China's middle-class population, the trend of consumption upgrading is

also reflected in the hotspot market. Frost & Sullivan's data shows that from 2013 to 2017, the mid-end hotspot market (within 60-200 yuan) grew the fastest, CAGR reaching 13.9%. While the high-end market (above 200 yuan; CAGR: 11.4%) and the mass market (within 60 yuan; CAGR: 10.7%) were slightly lower. In our opinion, with the increasing consumer awareness of food safety in the post-epidemic era and the increasing demand for food quality and catering environment, the mid-end and high-end hot pot market will continue to outperform in the next few years.

Of course, not all locations are suitable for hot pot, and not all entrepreneurs are suitable for hot pot. When doing product positioning, start-up catering enterprises should still integrate various factors to achieve the optimal solution:

4.3.1. To follow the development trend of the market

Conforming to the development trend is to meet the needs of market development. For example, fast food and simple meals are required needs, so choosing them conforms to the development trend. The category of health and nutrition is needed by the public, so investors can study in this direction. At the same time, China's catering market is catalyzing the segmentation of the catering industry, and the characteristic restaurants with a single category and main products are becoming more and more popular. The main products of these restaurants are single, but the products are popular, unique in taste and stable in quality. And because there are few products, the required site area is small, the rent and labor can be greatly saved. Thus, it can be easily profitable. This is also a trend in the catering market in the future.

4.3.2 To meet the needs of the region

China has a vast region, a large population, a huge catering market and a complex species structure, reflecting its diversity. Therefore, the product positioning should also be selected based on the consumption habits and tastes of local consumers. For example, the same product positioning is more suitable in the north, but may not be popular in the south.

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