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Food for Thought for the World's Restauranteurs

Restauranteurs will for the first time have a highly accurate way to measure their financial constraints, thanks to a pioneering index recently developed by Dr Sung Gyun Mun of the School of Hotel and Tourism Management (SHTM) at The Hong Kong Polytechnic University and his co-researcher. Although the restaurant industry is a vital driver of economic growth around the globe, restaurant firms are still subject to financial constraints that can pose a severe threat to their survival. Until now, little effort has been made to explore the financial pressure facing firms in the specific context of the restaurant industry. In their ground-breaking new study, the researchers offer restaurant managers a unique tool for measuring and mitigating these constraints, based on the financial and operational characteristics of the restaurants themselves.

The restaurant sector is experiencing phenomenal growth. In the US alone, the number of restaurant employees has reached 14.4 million, representing 10% of all US workers. Americans today are spending close to half of their food budget on eating out, and this trend shows no sign of slowing down. Restaurant sales are just as positive in Europe and Asia, where hospitality is a key driver of job creation and thus economic growth.

Nevertheless, challenges abound. Despite the sector's progress, the researchers note, "restaurant managers are not free from business obstacles, such as financial difficulties, policy instability, severe market competition and a lack of resources, knowledge or competence". Financial constraints pose a particular threat to businesses' survival and success. During the 2008 financial crisis, for example, financially constrained US firms were forced to cancel their investments and even to sell profitable assets to secure cash. This dramatically reduced employment, technology expenditure and capital investment, with devastating consequences for the US economy.

Clearly, given the major contribution made by the restaurant sector to economies worldwide, it is vital to help restaurant managers accurately identify the financial constraints facing their businesses. This will enable them not only to avoid financial risks in the short term, but also to promote sustainable business growth in the long run. However, research in this area is surprisingly scarce. "Only a few studies have investigated financial constraints in hospitality academia", write the researchers. To make matters worse, previous studies have tended to use roundabout ways of measuring financial constraints, as such constraints are not always directly observable.

Recognising the urgent need to directly measure the financial constraints faced by the restaurant sector, the researchers set out to develop "a new index that could reflect restaurant firms' unique financial constraint characteristics". The best way to do this, they decided, was to investigate the particular strengths and weaknesses of restaurant firms. Any truly effective index of financial constraints would need to accommodate multiple criteria, improving on the single-criterion measures used in previous studies.

The researchers' first task was to thoroughly review the literature to identify "the most distinctive features of financially constrained firms" in the restaurant industry. Six important characteristics emerged. The first was operating profit. They hypothesised that the more profit a restaurant makes from its operations, the less financially constrained it will be. Other positive features were asset tangibility – the number of physical assets a restaurant possesses – and employee number, because the restaurant industry is labour-intensive and "salary expenses account for a significant portion of overall operating costs". Pulling this information together, the researchers hypothesised that restaurants with higher profits, more tangible assets (such as property) and more staff suffer from fewer financial constraints.

On the other side, the researchers identified three characteristics of restaurant firms likely to increase their financial constraints. The first was accounts payable, the money owed by a restaurant to its suppliers. Another important debt-related variable was financial leverage, or a restaurant's ability to use its debt to acquire more assets. Finally, the researchers observed that selling assets "could be a financing source of last resort for firms with financial difficulties". They thus proposed that "as a restaurant firm's sale of fixed assets increases, it is more likely to be financially constrained".

Having identified these potential indicators of firms' financial constraints, the researchers needed to test their hypotheses with real data from the restaurant industry. In the US, job growth in the restaurant industry has outpaced the average, and restaurant firms continue to be among the key economic drivers through job creation. The US was thus the ideal setting to investigate real restaurants. The researchers selected more than 4,000 US restaurants for analysis and tracked their performance over half a century, from 1963 to 2014.

To find out which characteristics of restaurants make them particularly vulnerable to financial pressure, the researchers first divided the restaurants into two groups – more and less financially constrained than the industry average – to examine the six proposed indicators. To ensure that their model was as strong as possible, they also included several criteria used in past studies to measure financial constraints.

The next step was perhaps the most important of all. "When a new index is developed", the researchers observe, "it also needs to be validated". Not only was the index found to be suitable for restaurant firms, but compared with previous indexes, it also "better reflects conventional business characteristics in the restaurant industry".

A series of rigorous statistical analyses yielded critical insights into the factors predicting financial constraints in the restaurant industry.

An important early finding was that the money a restaurant owes to its suppliers does not significantly affect the restaurant's likelihood of being financially constrained. Therefore, this variable could be excluded from the analysis. The other five indicators, however, were just as important as predicted. In sum, the researchers reveal, "a restaurant firm's operating profit, financial leverage, asset tangibility, sale of fixed assets and percentage change in number of employees are critical indicators for identifying financial constraints".

This novel index provides a practical and readily adjustable method of assessing the financial constraints faced by any restaurant, as it is tailored to the unique characteristics of the restaurant industry. That is not only a ground-breaking departure from past research, but is also practically meaningful. "An appropriate understanding of a firm's level of financial constraint", explain the researchers, will help restaurant managers both avoid short-term budgetary risks and capitalise on opportunities for long-term growth.

Using this important new tool, explain the researchers, "restaurant firms' financial constraints can be estimated with more accuracy, and thus, actions taken to address financial constraints can be more effective". Imagine a restaurant under severe financial constraints – that is, scoring high in the new index. To overcome this weakness, the index tells us, the restaurant's manager need merely focus on securing and retaining liquid assets (such as cash) rather than fixed assets (such as property) to avoid unexpected cash shortfalls.

As if these findings were not promising enough, the index can be readily extended to hotels and other tourism businesses. Although external financing is critical to the operation of most hotels, note the researchers, studies to date have neglected the effects of financial constraints on hotel performance. Their newly developed index offers the perfect solution, benefiting not only restaurants and hotels but also their myriad stakeholders. Those wanting to invest in restaurant and hotel firms will now have a highly accurate way of establishing credit policies. Given the major contribution made by the hospitality sector to economies across the world, the implications are far-reaching.

Sung Gyun Mun and SooCheong (Shawn) Jang. (2019). Indicating Restaurant Firms' Financial Constraints: A New Composite Index. *International Journal of Contemporary Hospitality Management*, Vol. 31, Issue 4, pp. 2014-2031.

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