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HOW TO SECURE YOUR FUTURE

The Science of Site Selection,

Or

How comfortable are we on where to locate our business?

By Peter Buckingham

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Selecting a location for a business is one of the most important decisions you will make in your business life. If you are going into a franchise, this decision may be partially made for you, however most Franchisors will take all steps to ensure that this is YOUR decision, and one they have not made for you.

Whilst most large Franchisors have specialist property people, many smaller Franchisors operate the "Jack of ALL Trades" philosophy, and this function may sit with someone who is basically inexperienced in this important field. What I believe you should be asking the Franchisor is:

1. Do you have a process for selecting sites?
2. Do you have any quantitative analysis to support this?
3. Are there any sales prediction tools you use to assist in this decision?

Whilst the Franchisor may not wish to share his research with you, having some knowledge that research has been undertaken behind the scenes should assist in your confidence in their system. Some Franchisors will share this information whilst others just let you know that they have approved the site, and believe it is good enough for a franchise to operate there.

In many cases you are going to a bank to fund your investment, and the banks generally show more confidence in franchise systems they know and have approved for loans. This approval process varies from bank to bank, however one of the areas they explore is the method of site selection employed by the Franchisor. If you are able to show the bank some supporting material as to why the proposed site should be successful, then this definitely assists their approval process for your funding. Some Franchisors insist on you going to an expert 3rd party, and then the report that is generated can be given to the bank as part of their approval documentation.

The US approach

In the US, there is a real "stand off" approach by Franchisors as to assisting Franchisees in their site selection. I attended the last International Franchise Association Convention in Las Vegas in February 2007, and was surprised at how little the Franchisor would commit. Most Franchisors have a very detailed "Guideline" of what sort of site a Franchisee should secure.

Then they “introduce” you to an expert 3rd party who will assist you in finding the site, negotiate the deal, and filling in the SAR (Site Application Request) to the Franchisor.

Once the SAR is received, the Franchisor normally has 28 days to approve or decline the site. This is creating a new breed on real estate consultant, expert in their own city, to assist as being the approved person by the Franchisor for that city.

Whilst personally not supporting this approach, it probably has been bought about by Legal issues in the US, and we may be heading in this direction. The Lenard’s case broached many of these issues, and a current case with Muffin Break could raise this to a new height.

What can a Franchisor do to support new site selection, and show a prospective Franchisee that all due diligence and care has been exercised?

Levels of research available to a Franchisor.

The more sites a Franchisor has operating, the better should be their information and ability to have some predictive tools to use in site selection. I have been a great advocate of “Process” in site selection, probably built into me from my 20 years of oil industry experience.

I believe all Franchisors should be able to demonstrate a Process they use in site selection, which probably covers as a minimum:

- Initial site identification
- Suitability from a demographic view
- Physical site suitability
- Economic feasibility
- Final Approval

In the oil industry, we had records going back 80 years that show how old depots had been agreed upon, and probably 50 years (solo marketing started in the 1950’s) to show the justification on how a petrol station was selected and approved.

Low site numbers - (5 – 20 stores)

If you have 5 – 20 stores, you may be able to make some logic on why the best sites are doing well, and the lower performers are not so successful.

At this level of stores, a Franchisor should be able to model the demographics around his stores, and see if the better stores match his perception of the customers in terms of demographic of the area.

A Check Chart can be formulated using a combination of customer perceptions, plus the statistical results of looking at the demographics of the best stores.

Medium store numbers – (20 – 50 stores)

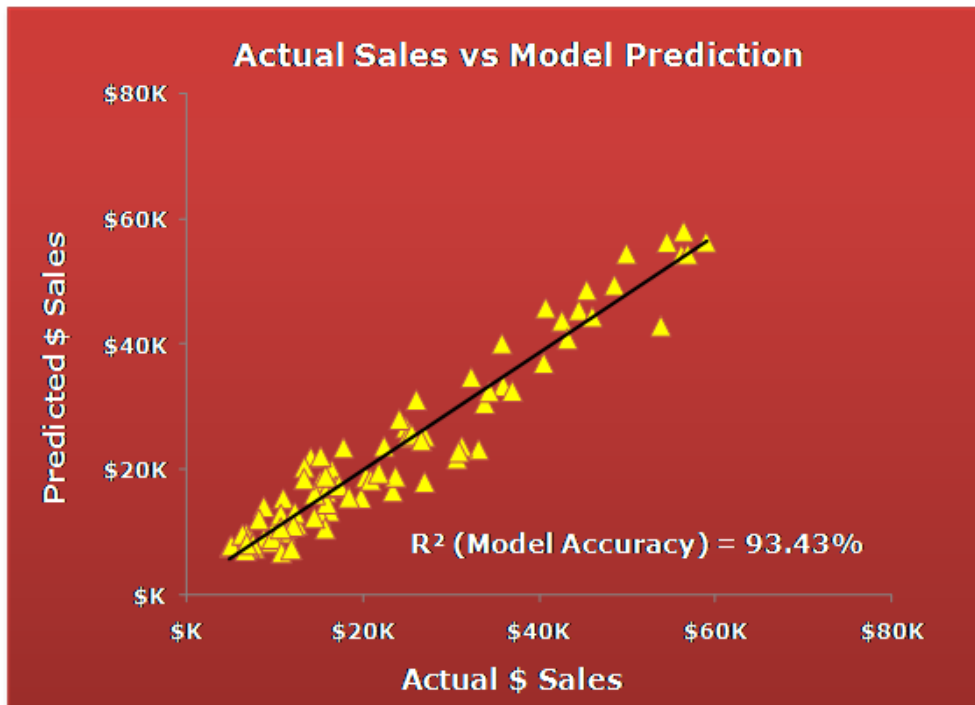
If you have 20 – 40 stores, maybe a percentage of those in the country, then you should have a much better check chart based on a larger sample size. At these numbers you can undertake a regression modelling process to identify the Drivers of the business, and then use some flexible logic to insert other variables you are confident assist in making for better stores.

Large networks – (50 - 150 stores)

For established large networks (50 - 150 stores); you can build a sales prediction model based on the sales being achieved by the network using regression modelling. This is done by a “Market Analysis” where:

- All existing stores are surveyed. The survey can incorporate issues such as size of building, number of counters and tills, seating (if a food business), access, store visibility, signage visibility, parking spaces and convenience, nearest neighbours and other business generators, and many other items. A survey like this also produces digital photographs of all aspects of the site, and gives a benchmark for comparison of stores and standards for the Marketing Department.
- Around 400 demographic variables are extracted for each store in the network either at different radii, by sales territories and/or by catchment areas.
- Competition and generators are then measured to determine which categories of business have positive or negative effects on sales. Possible distance effects, wherein the competitive or generative effect is only active within certain radii, are also examined.
- ‘Exposure’ is approximated based on traffic counts, signage and visibility, and a measure of pedestrian volume and flow.
- Sales information for all applicable outlets completes the dataset, plus any internal operations measures where available.

Statisticians then go to work to look for the best variables that explain the sales that are being achieved. We normally obtain a Sales Prediction model that typically incorporates variables from each of the above categories (survey data, demographics, competition/generators, exposure, and internal data). Though no guarantee can be given of individual results, we normally obtain models that can be said to be 70 - 80% accurate. The more consistent a brand is, the more accurate we expect the results to be.



The typical graph displays all stores in a network, each point showing where that store sits in comparing the actual vs. predicted sales.

Networks of 150+ stores – Neural Networks

The large networks we work with usually extend past regression modelling, into the use of Neural Networks. This is often called artificial intelligence and works on looking for patterns in the data that allow it to combine and create new variables that give a better result than can be achieved from pure regression modelling.

One of our clients had over 200 stores all in strip shopping centres, and all selling the same product. Regression modelling gave us 78% accuracy, whereas the neural network gave us an 86% level of accuracy. Please refer to the following hyperlink for more details in this area.

www.spectrumanalysis.com.au/PREDICTIVE_TOOLS/neural_network.html

Applying the science once developed

The sales prediction model aims at predicting the sales on mature or established sites, normally that have been open at least 1 year. In the oil industry, the sales of most service stations went through a 'ramp up' of 85% Year 1, 92% year 2 and reached their full sales potential (100%) in Year 3. Different businesses will have different ramp ups. In the fast food industry, we have seen cases where with big

opening promotions, some stores never again reach the sales level achieved in the first 4 weeks.

Once a Sales Prediction model is built and agreed upon, any new sites being considered can be run through the model to give a sales prediction at maturity. This may be done by the consultant, or internally if the company has all the necessary resources. Our experience is most companies tend to leave that with the Consultants as:

- They do not have the internal statistical expertise to run the models
- They do not have all the data necessary. Often the model includes some variables from Census 2006 and ABS Business Counts
- Staff changes, or staff are busy or on holidays, and they cannot keep up a 12 month service, but external consultants can provide these services all year round.

The Sales Prediction Modelling then becomes an integral part of the Approval process that a Franchisor undertakes. It should not be seen as the only part of the decision, as exceptions do occur, however it should be seen as a good “flag” as to what we should expect.

Though this is never 100% accurate, it should allow the Franchisor to have a set of ranges that guide further decisions in the Process. For example, a sales prediction in a range below the Network Average would provide a strong warning against proceeding, and special circumstances would need to be demonstrated to achieve approval. On the other hand, if a new store’s prediction is in the top 25% of Network Average, then a higher level of comfort in approving the proposal can be felt.

From a Franchisee’s view, although you may not see the results of this analysis (depending on the Franchisor’s willingness to share it with you), you should have more confidence in the System you plan to join if you know these types of processes are undertaken.

From a Franchisor’s view, not being able to demonstrate to a Franchisee some science and logical process in site selection, and subsequent site approval leaves you open to criticism, and ultimately can leave you open to litigation.

A final word came from the bench of the Federal Magistrates Court in October, where the Magistrate described the SWAG method of site selection:

- **S**cientific
- **W**ild
- **A**rse
- **G**uess

Hopefully this is NOT your Franchisor’s approach to site selection?

Summary

Use logic and science to make better site decisions. Implementing a Site Selection process can be very good insurance, and should help a Franchisee determine the more legitimate systems from the others. If a Franchisor cannot answer you in a confident way as to how they select sites, maybe you should look at other Systems to invest in.