# USING A SCIENTIFIC APPROACH FOR BETTER SITE SELECTION

## OR HOW TO AVOID SITE SELECTION FAILURE AND A FRANCHISEE LAWSUIT.

The psychiatric profession may have a jump in business as franchisors seek counselling for sleepless nights, hot flushes and nightmares about being dragged into a legal case over site selection with an unhappy franchisee.

Over the last 10 years there have been some classic cases which have normally involved very disgruntled ex-franchisees with a grudge to bear, and normally a franchisor who is not prepared for the scrutiny that comes around in court when a site has failed.

The scenario that normally leads into this litany of problems is as follows:

1. A failed franchisee, who feels they have been hard done by, for a multitude of reasons, and believe the franchisor, has been the cause of their failure.
2. A franchisor who probably believes the reason for the franchisee's failure was poor franchisee performance (and they are the worst franchisee they have ever had!)
3. A lawyer who asks a couple of questions to the former franchisee – hoping for some 'good' responses:

   **Question One:** *Did the franchisor indicate or promise you what sales you would make, or indicate what profit you should expect?*

   **Question two:** *How was the site selected?*
4. If the answer to question one is – "I was told I would sell $x or make $x profit", SEEK SETTLEMENT as you are in deep doo doo.
5. If the answer to question two is – "the franchisor just went along with what I suggested and did give approval to proceed without undertaking any internal analysis," then start to worry.

Nothing much, short of a miracle will save you from the revenue and profit promise of question one if that is what you or your staff has stated.

From a franchisor's view, if the answer to question two is we did nothing, just nodded our heads and agreed without any analysis or logic, then practice saying "Your Honour" at the end of every sentence.

The Lenard's case, which started in the late '90's is the classic example of how a company can have about 10 years of stress, and finally be proved innocent in the eyes of the Law, but the internal damage, let alone executive stress was massive for all concerned.

The first decision by the Federal Court of Australia on the 17th of September, 2004 was in favour of the Bakers (the former franchisees) against Lenard's Pty. Ltd. and their master franchisor for South Australia. The Bakers were awarded $198,800, less a cross claim of $21,416, with no decision at that time on interest or costs.

The case was then appealed to three judges of the Federal Court, where it became a victory to Lenard's. The Bakers then sought Leave to Appeal in the High Court of Australia, and this was rejected, bringing final closure to this very long case.

As a franchisor, it would be prudent to look at the situation Lenard's found them in, and see if you could be exposed in a similar way – would your site selection process pass the test?

Two years ago, Foodco (Muffin Break) went through a legal case which ended in tears for them also, losing to the tune of $316,570 + costs in a similar scenario.

I am not a lawyer, and it is not my intention to analyse the various cases that have arisen over the last 10 years. (The full transcripts are available on the Internet in most cases, and the original Lenard's case runs for 55 pages). Instead, I will look at some of the pitfalls that these cases expose, and some ways to avoid or at least minimise them.

Whilst there is no exact, formal way to do this and be 110% covered, the more you can be shown to follow good practices, the more confident you should be of having made the 'correct' decisions, and have facts and information to back them up.

A company has to decide how it will run its property department in terms of building up internal expertise, or outsourcing some or all of this expertise. Small franchisors have the largest issues, as when does it become cost efficient to run full time experts, compared to it being an ancillary job function of a senior executive.

The options for running a property or network development department include:

1. run a full in-house department
2. have a combination of internal and external people to undertake the work
3. have all property issues done externally.

Whatever the choice, if you don't have some process in place, you may find yourself on the wrong end of a nasty legal case. Unfortunately, you will probably start behind the eight-ball as, in these cases, the franchisee is normally perceived as 'the little guy' seeking justice from the big, bad franchisor.

## QUESTIONS FOR FRANCHISORS

The questions franchisors need to ask themselves should include:

Internally

- Is there a process we use that can be accountable and reproducible for our decisions?
- Is there a work instruction in place we can show?
- Do we have some form of sales prediction tool we can rely on?
- Would these tools be explainable and hold up to rigorous investigation?

Externally

- What level of information should we give to a franchisee to assist in selling our franchise?
- What should franchisees be expected to do (that we can assist with) to give them comfort to proceed?

## PROPERTY DEPARTMENT OPTIONS

**In-house property departments**

Only very large companies can normally afford the luxury of a full, in house property department. As a former property manager within Caltex, we had around 10 people full time on property before the 1995 merger with Ampol. Companies like McDonald's, oil companies and the banks still tend to run in-house analysts within the property departments, and build or buy tools to assist their people's decision-making ability. For example, companies like MPSI from the US have been doing sales prediction modelling for the oil industry for years, and many oil companies in diverse markets subscribe to their products.

Some large franchise groups in Australia run internal property departments. I believe that in light of the Lenard's case, they need to evaluate the tools they use, and if they would stand up to legal examination.

**Combination of internal employees and external consultants**

Many large and middle size franchisees work to a model with a combination of internal property managers, and external consultants to build models and produce sales predictions, demographic area reports and site potential reports which the companies can rely upon. This normally involves the external consulting company (such as Spectrum Analysis) undertaking a market analysis and building a sales prediction model based on the learning's of the existing network. How the company addresses the knowledge with future franchisees is up to them.

**Externally outsourcing all property issues**

We come across some companies who chose to outsource all property issues including finding sites, negotiating leases, and justifying to the board to proceed. The measure of this approach must be in the quality of what is delivered and cost compared to what can be delivered with either models one or two.

**The Process**

One way of ensuring a rigorous site-selection or territory distribution process and avoiding the fate of Lenard's, Foodco and the Great Australian Ice Creamery is to take into consideration:

- demographic analyses of the areas (both residential and business / employment)
- power of the shopping centre, be it a mall or a strip
- a sales prediction based on the established drivers of the business.

In addition, there should be a final decision-making phase that will take all factors into account. You might need to disregard the information from some areas of the process because of some special circumstance. An example of this is a coffee lounge on Rottenest Island, which performed very well but did not fit any normal sales prediction tools.

Once there is a formal process in place, you should be able to have some comfort or defence against a situation such as Lenard's faced.

**Sales Prediction Modelling**

The core tool for any analysis is convincing or comforting yourself that you have some understanding as to what the sales of the business should be. If the top line or gross revenue is out by 100%, then all the numbers and profit projections on a forecast profit and loss are worthless.

Companies such as Spectrum Analysis work to give you some level of confidence in the sales projections you make internally, to convince yourself that a new location should proceed.

We believe that for established large networks (40+ stores); you can build a sales prediction model based on the sales being achieved by the network. This is done by a market analysis where:

- All existing stores are visited and 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 complete 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 per cent accurate. The more consistent a brand is, the more accurate we expect the results to be.


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

The sales prediction model aims at predicting the sales on mature or established sites, normally that has been open at least one year. In the oil industry, the sales of most service stations went through a 'ramp up' of 85 per cent in year one, 92 per cent in year two and reached its full sales potential (100 per cent) in year three. 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 four 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
- staff change, 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 per cent 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 per cent of network average, then a higher level of comfort in approving the proposal can be felt.

This modelling can also act as a tool in evaluating the existing network for their actual sales against potential, and classifying the stores for certain marketing actions.

## SUMMARY

The Lenards and Foodco (Muffin Break) cases should make all franchisors look at the process they have in place for site selection. These cases must be giving disgruntled franchisees heart that they may be able to lay the blame for financial failure back on their franchisors, if they cannot show some logic and process in how they went about site selection.

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**Spectrum specializes in assisting clients with decisions relating to store location analysis and territory planning, using various scientific and statistical techniques. To contact Peter email peterb@spectrumanalysis.com.au or call on (03) 98826488.**