9th September 2008

Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100 Parliament House
Canberra ACT 2600

Inquiry into the Franchising Code of Conduct

Dear Secretary,

Please find attached my submission to the Inquiry into the Franchising Code of Conduct.

The Code was designed to improve equity in an industry that can at times invite exploitation, yet critical disclosure provisions are weak or ambiguous to the extent that some provisions do not even find their way onto ACCC checklists.

My submission is motivated by the bitter experience of my family as franchisees; my concerns focus largely on aspects of the Code that relate to the selection of sites and territories, and associated disclosure requirements.

I have sought to illustrate the basis for my concerns by briefly setting out the background to my family's franchise experience, and then in each point noting the franchisor's conduct.

Please accept that my motivation is simply to see the Code improved in order that others might be spared my experience. Changes to the Code can not have any affect on the outcome of my personal dispute with the franchisor in question.

I thank the Committee for this opportunity to contribute, and look forward to a much fairer franchising environment as a result of this enquiry.

Sincerely,

Dave Johannsen

DW Johannsen

SUBMISSION

to

The Parliamentary Joint Committee
on
Corporations and Financial Services

Inquiry into the Franchising Code of Conduct

from

David W Johannsen

1. Summary

1.1 This submission seeks to focus on the underlying inequity that can exist in a franchisor/franchisee relationship, with particular regard to the site selection process.

1.2 In keeping with the terms of reference of the Inquiry, this submission therefore contends that:

1.3.1 There is a need for the Code to confer a 'duty of care' responsibility on franchisors with regard to the sites that they offer franchisees.

1.3.2 The Code should place an obligation on all parties to act in good faith, and this should include a specific obligation on franchisors to act in good faith when selecting and allocating sites and territories.

1.3.3 The Code relies on section 51AC of the Trade Practices Act 1974 with regard to unconscionable conduct and good faith. However 51AC refers to the supply and acquisition of goods and services without specific reference to the selection and allocation of sites and territories.

1.3.4 Dispute resolution provisions in the Code should be reinforced to prevent either franchisor or franchisee from threatening or initiating legal action in a manner that might intimidate the other party into not pursuing a mediated settlement. Such reinforcing of the Code should also prevent a threat of legal action against individual guarantors.

1.3.5 The Joint Committee may also wish to consider the following related matters:

a. Disclosure of franchisor's site selection policy.
b. Disclosure of franchisor's earnings information.
c. Three sided relationships in the franchise model.
d. The need for a Peak Body to exclusively represent franchisees.

2. Background

2.1 The writer has no legal experience or qualifications.

2.2 The writer is one of four directors of Gourmet Beans Pty. Ltd., a family company established as the vehicle to operate coffee shops franchised by a leading Australian coffee franchisor.

2.3 Gourmet Beans has successfully operated franchised coffee shops in Darwin since July 2003.

2.4 In April 2005 Gourmet Beans was offered a franchised site in Maroochydore on the Sunshine Coast.

2.5 The Maroochydore site had been selected by the franchisor 'off the plan' in a new residential/commercial development.

2.6 At the time of offer the development was in the early stages of construction.

2.7 in May 2005 Gourmet Beans accepted the offer of the franchise.

2.8 In December 2005 the franchised store opened as **the only tenant** in a strip of eight commercial tenancies along the development's river frontage.

2.9 In December 2006 Gourmet Beans closed the franchised store.

2.10 Gourmet Beans' trading and capital losses for the Maroochydore store totalled around $385,000.00.

2.11 The franchisor has sought to avoid any degree of shared responsibility for the failure of this franchise by:

a. Denying that it as franchisor selects the sites that are offered to their prospective franchisees.
b. Denying therefore that it selected the Maroochydore site.
c. Insisting instead that Gourmet Beans had selected the site.

2.12 In March 2008 the franchisor threatened to issue a Statuary Demand claiming $112,000.00 from Gourmet Beans as damages and legal costs for an alleged breach of the Licence Agreement.

2.13 A mediation process has begun aimed at resolving the various issues generated by the failure of the Maroochydore franchise.

Terms of Reference - Point 1.

3. The need exists for a 'duty of care' responsibility to attach to franchisors with regard to site selection.

3.1 The single factor having the greatest influence on whether an individual franchisee succeeds or fails is the viability of the allocated site or territory.

3.2 It is my family's experience, and it may well be established practice in the franchise industry, that a franchisor will seek to quarantine itself from responsibility should a franchise fail by denying that the franchisor selected the site, and by insisting instead that the franchisee selected the site.

3.3 The effect of this denial/insistence is that all risk associated with a particular site, including liability for lease payments for the full term of the lease, is transferred to the franchisee.

3.4 The global effect for franchisors who are able to successfully deny selecting sites, is that their franchise operations can grow at little or no risk to the franchisors.

3.5 In a market place where competition for good sites is vigorous, this transfer of risk can only cause franchisors to be less cautious in selecting sites than they would otherwise have been had the risk remained to their account.

3.6 In this light, a comparison should be made between a franchisor in a given industry, and a 'corporate' competitor (one who owns, develops and operates its own stores) in the same industry.

3.7 The corporate competitor must bear all the risk associated with each store.

3.8 The degree of care taken in the site selection process of the corporate competitor will, as a consequence, reflect this risk.

3.9 We have the example of the Starbucks organisation which recently closed a large number of under-performing stores in Australia, at a cost to Starbucks of millions of dollars.

3.10 In an ideal world the Code would correct this inequity:

a. By conferring on the franchisor the same degree of risk that a corporate competitor has to accept.
b. By obliging the franchisor to accept the consequences of poor site selection to the same extent that a corporate competitor must accept those same consequences.

Terms of Reference - Point 2.

4. The obligation for all parties in the franchising industry to act in good faith should be explicitly incorporated into the Code, and this obligation should expressly apply to franchisors when they select franchise sites or territories.

4.1 It is generally accepted that in the franchising model, power is inequitably weighted in favour of the franchisor, to the detriment of the franchisee.

4.2 Experience obliges me to compare franchising to a poker game where the four aces have been set aside for the franchisor to draw on exclusively and at his discretion, in circumstances where the other players, the franchisees, are not made aware of this little twist in the rules until they are irrevocably committed to the game.

4.3 A franchisor acting in good faith, that is 'with the honest intent to act without taking unfair advantage', would not even consider drawing unfairly on the aces available to him. Sadly, and as my family has experienced, some franchisors exercise their unfair advantage with every hand that they play.

4.4 Indeed, some franchisors have only joined the game because they know that they enjoy this unfair advantage.

4.5 Were this not the case, it would not have been necessary to replace the 1993 voluntary code with the mandatory code of 1998.

4.6 Regardless of any reference in the Trade Practices Act 1974, inclusion in the Code of an explicit obligation to act in good faith would serve to help balance the existing inequity between franchisor and franchisee.

4.7 The need exists to further balance the relationship by making specific reference to the need for good faith in the process that selects and then allocates individual franchised sites and territories.

Terms of Reference - Point 3.

5. There is a need to ensure that unconscionable conduct provisions in the Act apply to aspects of franchising that are industry specific.

5.1 Unconscionable conduct provisions in the Act point to the extent to which the parties acted in good faith [51AC(3)(k) and 51AC(4)(k)] with regard to 'the supply or possible supply of goods and services' and 'the acquisition or possible acquisition of goods or services'.

5.2 The Act, and in particular the obligations contained in section 51AC, make no mention of site or territory selection. This aspect of commerce, since it is franchise related, should be covered quite specifically in the Code, and in a way that reinforces unconscionable conduct provisions in the Act.

5.3 There is no question that franchisors select the individual sites that they offer to prospective franchisees.

5.4 The attached document 'The Nine tips to Great Site Selection', written by Peter Buckingham, spells out both the complexity of the site selection process, and its pivotal importance to the franchisor, from strategic network planning down to the the identification and assessment of individual sites.

5.5 It is an absurdity to suggest that an individual franchisee could match either the resources or the expertise needed and utilised by the franchisor in planning and executing a network development strategy.

5.6 Yet the licence to make such an absurd claim exists, as the following statement by the coffee franchisor that offered my family the site in Maroochydore demonstrates:

> "(XYZ) does not select sites, (XYZ) locates locations suitable for a coffee offering, but it is the franchisee that selects the site..."

5.7 Clearly, in making this statement and thereby denying any responsibility for having selected the site, the franchisor in question feels secure from any good faith and unconscionable conduct provisions of the Act.

5.8 The possibility that this feeling of security arises from the lack of specific reference in the Act to the selection process needs to be considered, and if necessary addressed by amending the Code.

Terms of Reference - Point 4.

6. Dispute resolution provisions in the Code do not seem to prohibit either party from threatening or initiating legal action prior to commencing the mediation process.

6.1 Perhaps this is the reason why our Maroochydore coffee franchisor sought to initiate legal action against Gourmet Beans rather than, or prior to, commencing a mediation process.

6.2 Perhaps this is the reason why our Maroochydore coffee franchisor sought to initiate legal action against the four individual guarantors of Gourmet Beans rather than, or prior to, commencing a mediation process.

6.3 Perhaps this is why Gourmet Beans lawyers needed to remind our Maroochydore coffee franchisor that it was ignoring its obligation under its Licence Agreement to 'endeavour in good faith to resolve the dispute... using informal dispute techniques such as mediation... '.

6.4 If it was the intention of the legislators who framed the Code to oblige both parties to exhaust informal dispute resolution such as mediation prior to initiating legal action, then it could be that this requirement needs to be spelled out with more clarity in the Code.

6.5 Failure to clarify this requirement, and/or failure to give the requirement a few more teeth, could be an open invitation to either party to chance their arm at intimidating the other side into settling, where mediation may have produced a fairer result.

Terms of Reference - Point 5.

7. The Joint Committee may wish to consider the following related matters:

7.1 Disclosure of the franchisor's site selection policy;

a. Annexure 1, titled 'Disclosure document for franchisee or prospective franchisee', under 'long form disclosure document' states:

> 11 **Sites or Territories**
>
> 11.1 The policy of the franchisor, or an associate of the franchisor, for selection of as many of the following as are relevant:
>
> (a) the site to be occupied by the franchised business;
>
> (b) the territory in which the franchised business is to operate.

b. The ACCC Franchising Code of Conduct compliance manual, under 2.3 Checklist - disclosure 'How do I create a disclosure document?' states:

> **"When a franchise expects to have an annual turnover of more than $50,000 at any time during the franchise agreement, your disclosure document must be in accordance with the long form disclosure document set out in annexure 1 of the code.**

c. However the ACCC Franchising Code of Conduct compliance manual, under 2.3 Checklist - disclosure... 'How do I create a disclosure document?', fails to include this declaration by the franchisor in a list of disclosures that could be considered to be obligations.

d. The ACCC Fact Sheet 'Disclosure under the Franchising Code of Conduct', under 'Long-form disclosure document requirements', again fails to include this declaration by the franchisor in a list of disclosures that could be considered to be obligations.

e. What appears in the Code to be a requirement on the part of the franchisor to disclose the basis on which sites or territories are selected has at best been rendered ambiguous by the ACCC's interpretation.

f. The disclosure document of our Maroochydore coffee franchisor, for example, states under 11.1.a:

> 'It is the responsibility of the franchisee to select a site for the franchised business, however the franchisor may assist the franchisee by identifying potential sites that may be suitable for the conduct of (an XYZ) store.
>
> It is the responsibility of the franchisee to approve any site identified by the franchisor.
>
> The franchisee must make its own independent investigation and conduct its own due diligence to satisfy itself that the site is suitable for the operation of the franchised business.
>
> Whilst the site to be occupied by the franchisee must be approved by the franchisor, the franchisor does not make any warranty as to the future potential of the site or its suitability for the conduct of (an XYZ) store.'

g. While this statement purports to be a disclosure, it is effectively a denial that the franchisor selects sites, and therefore a deliberate attempt to transfer responsibility for site selection to the franchisee.

h. This question of whether disclosure of the franchisor's site selection policy is an obligation or simply an option needs to be clarified.

7.2 Disclosure of the franchisor's earnings information

a. Annexure 1, titled 'Disclosure document for franchisee or prospective franchisee', under 'long form disclosure document' states:

> 19 **Earnings information**
>
> 19.1 Earnings information for the franchise, if it is given, must be based on reasonable grounds.
>
> 19.2 Earnings information may be given in a separate document attached to the disclosure document.
>
> 19.3 Earnings information includes information from which historical or future financial details of a franchise can be assessed.

19.4 If earnings information is not given — the following statement:

The franchisor does not give earnings information about a [*insert type of franchise*] franchise.

Earnings may vary between franchises.

The franchisor cannot estimate earnings for a particular franchise

b. In circumstances where the resources and expertise of the franchisor have been able to identify sufficient potential in a site to offer that site to a prospective franchisee, clearly the franchisor has estimated sufficient earnings for that site to enable it to make the offer.

c. Assuming that 'franchises', and 'franchise' as mentioned in the last two lines of 19.4 refer to individual franchise sites, the franchisor has therefore been invited to make a false statement.

d. This anomaly should be addressed.

e. Despite having identified sufficient potential in the franchise site to offer the site to Gourmet Beans, the Maroochydore coffee franchisor stated the following in its disclosure document:

'The Franchisor does not give earnings information about (an XYZ) coffees franchise.

Earnings may vary between franchises.

The Franchisor cannot estimate earnings for a particular franchise.'

7.3 The Code does not seem to have anticipated the inherent inequity of three sided relationships in the franchise model.

a. Examples of these three sided relationships might include:

i. Franchisor, franchisee and site lessor.

ii. Franchisor, franchisee and store designer.

iii. Franchisor, franchisee and shop-fitter

iv. Franchisor, franchisee and certifier (building, health etc.)

b. In many of these three sided relationships the franchisee ultimately meets all the cost, but may be excluded from any negotiations.

c. Despite having been excluded, the franchisor bears the consequences of any such negotiations.

d. By way of example, the Maroochydore coffee franchisor negotiated the lease before offering the site to Gourmet Beans.

e. The Maroochydore coffee franchisor then negotiated in an ongoing manner with the lessor, firstly as the situation deteriorated, and secondly in seeking to reach a settlement with the lessor after Gourmet Beans had vacated the premises.

f. In these latter negotiations Gourmet Beans as sub-lessees were deliberately excluded from the negotiations but potentially bore the full weight of the outcomes.

g. This inequity inherent in the franchising model should be addressed.

7.4 The need for a Peak Body to exclusively represent franchisees.

a. The Franchise Council of Australia states:

> 'The Franchise Council of Australia Limited (FCA) is the peak body for the $128 billion franchise sector in Australia, representing franchisees, franchisors and service providers to the sector.' (The FCA Overview)

b. The franchising sector is one of only three industry groups to have attracted the attention of our regulators to the extent that it was deemed necessary to impose a prescribed mandatory industry code of conduct. This followed the failure of a voluntary code.

c. While the Code was framed to regulate all participants, it is generally accepted that in the franchising model, power is inequitably weighted in favour of the franchisor, to the detriment of the franchisee.

d. In an industry where a mandatory code was deemed necessary to protect the weaker side against the excesses of a dominant stronger side, it is difficult to accept that a peak body could realistically claim to equitably represent the interests of both sides.

e. While the FCA may well be able to cover some aspects of franchising without compromise, clearly there will be some issues where FCA has to choose between franchisors and franchisees and act in the interests of one side to the detriment of the other.

f. This potential for compromise is evident in:

i. The number of FCA members that are franchisors in contrast to those that are franchisees.

ii. The lack of value in FCA membership for a franchisee compared to the value for a franchisor.

iii. The extent of FCA member services that are franchisor focussed as compared to those that are franchisee focussed.

iv. The degree of intervention and financial support given by FCA to franchisors in legal disputes involving franchisors and franchisees.

v. The FCA's belief that 'the franchise sector is well regulated' by the existing Code, and their reliance on toothless 'best practice guidelines in the form of member standards' to further develop the relationship between franchisor and franchisee.

vi. The FCA's failure to seek clarification of or improvements to the Code that would further protect franchisees in the area of site selection.

g. The FCA should not be presenting itself as the peak body representing franchisees.

h. There is an urgent need to establish a separate body that will promote the interests of franchisees without compromise.

i. Reportedly, the franchise sector employs 600,000 Australians and boasts an annual turnover of $128 billion, some 14% of our national GDP. (FCA website)

j. Establishing independent representation for franchisees by way of their own peak body is possibly the most effective way that implementation of the values contained in the Franchising Code of Conduct can be fostered and improved.

k. Given the disparate nature of franchisees, and the fact that compared to franchisors their individual involvement in franchising is more likely to be transient, it is unlikely that such a body, necessary as it is, will establish itself.

l. Establishment of this body may require legislative assistance.

The Nine Tips to Great Site Selection

By Peter Buckingham

Index and tips to better site selection

Chapter 1: The Network Planning Process

Understand where you are in the Network Planning Process before considering individual sites. It is no good picking and opening a few random sites, and then trying to fit a Network Strategy around them later on.

Chapter 2: The Big Picture

Tip 2: Think in terms of whom your customers are (and where to find them) as the first way of selecting areas to look for individual sites.

Chapter 3: Shopping Centres vs. Strips

Tip 3: Are you able to afford the rents for a high exposure site, or should you be looking for lower exposure, lower rental stores in shopping strips? If you have a concept large enough to be in both, then be aware of the higher costs in shopping centres, as well as the normally reduced tenure and rarely offered option.

Chapter 4: Impulse vs. Destination

Tip 4: Do you understand where your concept lies in terms of 'Impulse vs. Destination'? The higher the product is an 'impulse', the more important to be in a high exposure location.

Chapter 5: Friend or foe? Is Clustering Good or Bad?

Tip 5: It is normally far better to be in a cluster with your competition than out on your own, trying to draw customers to you. Think of being in a cluster as a friend, and on your own as a foe, as the power of the group is far stronger than the individual.

Chapter 6: Finding the Appropriate Site in a Shopping Centre

Tip 6: Decide on the precinct you feel is most appropriate for you to operate. In large centres, look where that precinct is, and what opportunities are available in it. If it is a general concept, then look to where other general stores are operating, so they are also similar in the 'Impulse vs. Destination' ratio.

Chapter 7: Finding the Appropriate Site in a Shopping Strip

Tip 7: Look for the precincts within the strip where you want your concept to be. Think of the 'day time vs. night time' traffic, and be aware of the different rentals the different precincts charge you.

Chapter 8: Establishing a Process

Tip 8: Once you have a management approved process, it is extremely important that you are honest to yourself in applying it, and that you keep file records of the decision process, as well as the outcomes, so if you are challenged in the future, you can explain your process.

Summary

Tip 9: Site Selection is an extremely important part of the business, and as a network increases in size, there is less "low hanging fruit"; it becomes increasing important to understand the process as the decisions become progressively harder.

Chapter 1: The Network Planning Process

Over the years, I have been involved in site selection for an oil company (Caltex), and now with our own company, acting as a consultant to many major brands. The issue of good site selection is one of the most critical things in making a business successful rather than a failure.

To understand the principles of site selection, you first have to think in terms of the **Network Planning Process**, of which actual site selection is one of the later steps in the process.

We believe the Network Planning Process follows a series of steps from the macro level to the site-specific level. Therefore, our description of the processes at work is as follows:

1. A company needs to decide to have a long-term presence in a country (Global issue) or a state within Australia. This can be decided by anticipated returns, political climate or priority of funding.

2. Once the long-term position is established, a macro plan is required to look at which areas to expand. This can be looking at (a) the total number of sites, (b) total potential market, and (c) how to divide allocation (possibly at a regional level).

3. The next level then requires a plan to look at which localised areas (maybe suburbs) the company wishes to locate, and the priorities of these areas. In an established market, this evolves to a network purification process as we look for improved new opportunities whilst we cull out the lowest performers in our network.

4. Specific site selection is then the next step as individual opportunities are sought, then evaluated using tools such as those discussed further in this E-Book.

5. Continual review, or post audit, is then undertaken to improve on the decision making process. This involves bench marking and comparison to the original forecasts. Once a site has gone through a 3 - 5 year operation cycle, little else can be learnt from the original prediction, so we then need to keep a less strenuous review program to ensure it is economically viable to continue.

Once you see this as a Network Planning Process (that you are either consciously or unconsciously following), you can begin to break down the steps.

Tip 1

Understand where you are in the Network Planning Process before considering individual sites. It is no good picking and opening a few random sites, and then trying to fit a Network Strategy around them later on.

Chapter 2: The Big Picture

Some years ago, I was on a special worldwide project team with Caltex, and whilst we were setting up tools for use around the Caltex world, a second group were addressing the start of the network planning process (as far as China was concerned).

Caltex wanted to move into China, and the issues they were looking at were:

- Where should we start as far as which province should we invest in?
- What level of investment do we begin with?
- Do we bring in product to start, or move to building a refinery?
- Where should we market initially?
- How should we market? (i.e.: retail, wholesale, government use, etc).

These types of macro issues are the first things a company needs to address if undertaking a start-up business. Naturally, Caltex were very experienced across Asia, and could apply a great deal of logic and science to their decision process.

Different types of business will have a higher probability of success if the goods or services being sold match with the type of person living or working in that area.

In most countries (including Australia), we have a very thorough Census conducted on a regular basis (normally every five years). The Census allows us to look at particular areas and understand issues like:

- Population levels
- Marital status & family types
- Education levels
- Income levels (both household and individual)
- Age Profiles
- Ethnicity (i.e.: language spoken at home, birthplace, etc)
- Housing structures
- Property Ownership (including levels of rent or mortgage payments)

There are many fields, and when we think of what we know of the people, we can start to match it with what they are most likely to buy.

We like to image that there is one person living in each area (be it a postcode, census collection district, council area, etc), and what is the likelihood of that "person" wanting your goods or services.

If we imagine that the "person" is worth, on average, one "Unit of Demand", then if the fit is good for the area, then the one "person" may be worth 1.5 units of demand, and if the fit is poor, the "person" may be worth only 0.5 units of demand.

Example

I may have a swimming pool cleaning company, and following some research I have undertaken with my customers, I have concluded that my typical customer:

- Has a high level of income (because they can afford to have me do it, as they are "time poor"), and
- Is older than 50

If I look at the demographics, then my best customers will come from high income, older areas, and my worst customers will come from the opposite (i.e.: probably a low income, young family area).

A person from an area like Toorak (in Melbourne) or Double Bay (in Sydney) probably has twice the chance of using a pool cleaning service than a person in "Average Australia". Therefore, in these areas, our "person" is worth 2 Units of Demand.

By contrast, a low income, young family area like Carrum Downs (in Melbourne), Beenleigh (in Brisbane) or Albion Park (in Sydney) probably only has half the chance of using my service than "Average Australia".

If I now want to estimate the demand for my service, it becomes the 'Unit of Demand' for each area, multiplied by the actual population.

In Toorak for instance, I have decided each person is worth 2 Units of Demand, and if the population is 10,000 persons, then I have 20,000 Units of demand in that suburb or postcode.

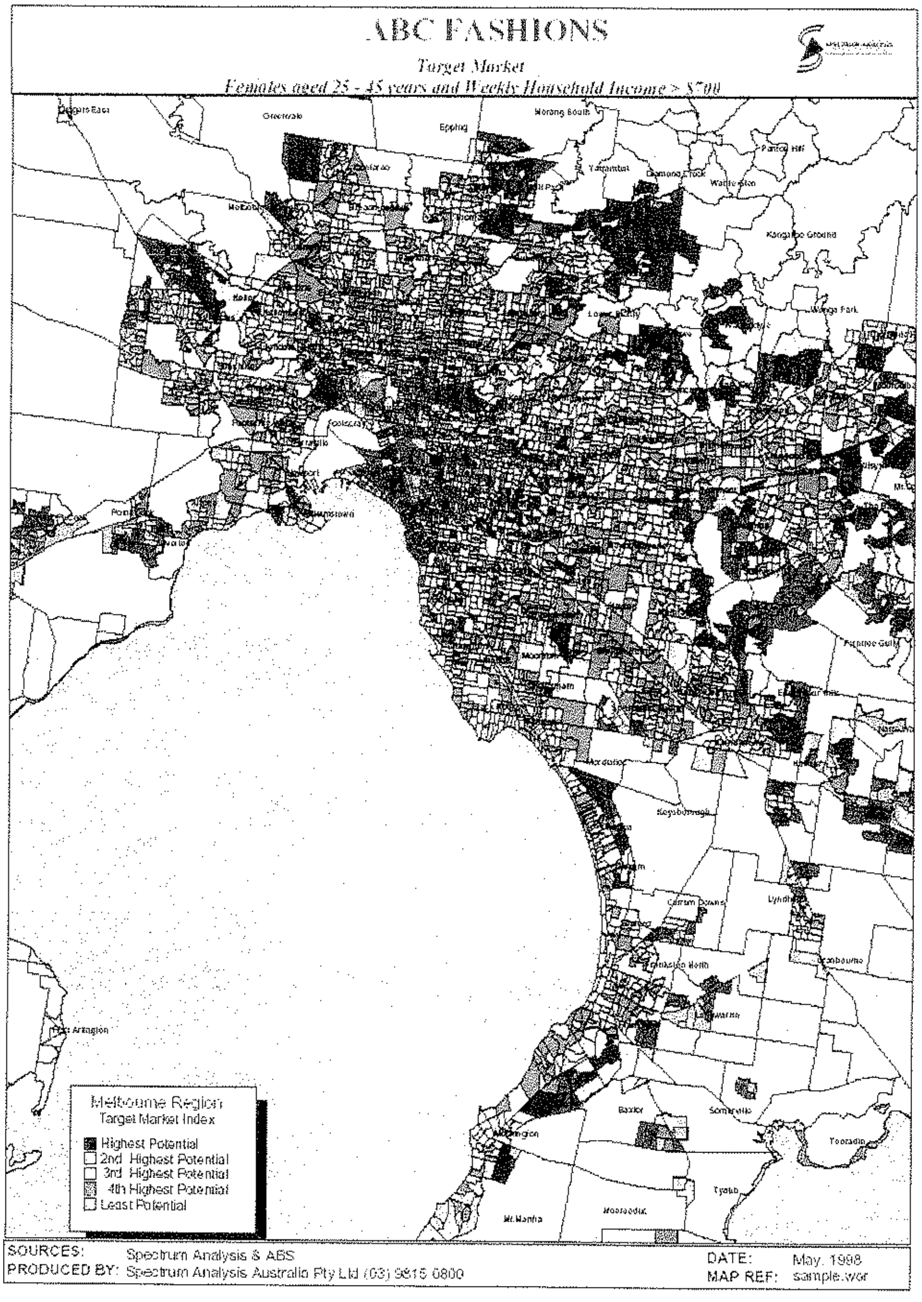
By contrast, an area like Albion Park, where we have concluded each person is worth 0.5 Units of Demand, and there are 25,000 persons, then I have only 12,500 Units of Demand in that suburb or postcode.

I can then see which areas are best for my product or service. As such, if I were going to open an up-market pool shop, and specialize in servicing the local pools, Toorak would offer a better opportunity than Albion Park.

Target Market Index

The material above can then be displayed on a map, so that we can see which areas have the best probability of a person using our service. This is done using mapping software and Census data, so you can combine multiple variables to create a value for each area, and then show that on a map.

Below is an example of a Target Market Index map:



Area Selection

If we have undertaken a TMI map, we can then “hot list” the areas we feel that are most appropriate for our goods or services, and begin the next step of looking for actual locations.

Tip 2: Think in terms of whom your customers are (and where to find them) as the first way of selecting areas to look for individual sites.

Chapter 3: Shopping Centres vs. Strips

Many businesses have a preference to go into big Shopping Centres (or malls), whilst others believe shopping strips are the go.

Shopping Centres definitely have high attraction power for the customers, as the volume of traffic is normally very high. In Australia, we can gather the basic statistics on Shopping Centres from the Property Council of Australia, who produce books giving a page of details for nearly every shopping centre in Australia (unless the owner is not a member of the Property Council of Australia, and does not wish to be included).

The Property Council data tells us the owner, manager and their contact details. It also tells us the GLAR (Gross Lettable Area Retail) and MAT (Moving Annual Turnover) of the centre, as well as details on the major tenants, number of car parks, specialty stores, estimated pedestrian traffic, and details on major refurbishments of the centre.

Different owners may collect data in different ways, so we are at the mercy of the details supplied to the Property Council.

In the case of shopping strips, there is no formal collection procedure, or body, that acts like the Property Council. We use a product called 'Strip Locator', which is a method of comparing one strip to another as an indication of the strength of the strip. The comparisons as we see it are:

	Shopping Centre	**Strip Shopping**
Traffic	Normally higher in a SC (and measurable)	Lower and unpredictable
Product mix (i.e.: competitors)	Some governance in a Mall, depending on the owners, as they can limit the competition if they wish	No protection from your competition acting any way they wish
Rents	Normally much higher, with little long-term protection	Higher chance of a lower rental
Long-term renewals	Currently most SC's will give only a 5-year lease, with no options, so you are at their mercy at time of re-leasing	More likely to be able to negotiate longer tenure, including options for lease renewals

Tip 3: Are you able to afford the rents for a high exposure site, or should you be looking for lower exposure, lower rental stores in shopping strips? If you have a concept large enough to be in both, then be aware of the higher costs in shopping centres, as well as the normally reduced tenure and rarely offered option.

Chapter 4: Impulse vs. Destination

Before selecting a site, you need to think about how my product rates, in terms of 'Impulse vs. Destination'. If we think of it in terms of a line, where do we sit on that line?

High Impulse Low Destination	Low Impulse High Destination

High Impulse items

High impulse items are usually low cost, spontaneous purchases, such as buying a carton of milk, a packet of cigarettes, or a newspaper. You may make some decision where you go, but convenience normally drives this purchase.

When we look at the most 'High Impulse' business we can imagine, think of a 'Busker'. In this case, they are very mobile, and are able to move to the best traffic flow at no cost, other than moving their instrument and case and walking to the other side of the pavement or whatever.

As the cost of the goods you are purchasing increases, you move further along the line towards 'Low Impulse / High Destination'.

High Destination purchases

If the goods you want are reasonably expensive, and you have already pre-determined where you will buy it from, then that is considered a 'high destination' purchase. If you want a specific type of car, such as a BMW, then you will travel to a BMW showroom.

Giving a value to this 'Impulse vs. Destination' ratio

Your business can normally be addressed as x% impulse; y% destination, and I shall give some examples:

Busker	100% impulse	00% destination
Rolling Stones Concert	01% impulse	99% destination
Buying Petrol	80% impulse	20% destination
KFC	60% impulse	40% destination
High-class restaurant	20% impulse	80% destination
Buying small electrical goods	70% impulse	30% destination
Buying a plasma screen	20% impulse	80% destination

As you can see, the more pre-meditated the purchase, the higher the probability you will look up where you want to go, not just spontaneously make a purchase from the first store you see.

The decision

That being said, the higher the impulse value of the goods you are selling, the more importance to be in a highly visible, high traffic location. If you are a very strong destination product, then you can take a more back-street approach.

The rental you pay for a property is probably defined by the owner's view on whether the premise is a high traffic / high visibility location. In shopping centres, most stores have a different rental / sq.m., depending on centre management's view on these factors.

What you need to do is pay the appropriate rental for the appropriate store, and if you have a high destination type product, then you do not want to be paying top rental for the peak corner in the centre. If you are a high impulse product, then you do need high passing trade, or you will not sell your goods. There's no point being down at the back of the shopping centre, paying cheap rental, if you have a high impulse product such as phone cards, sandwiches or other food items.

An exclusive restaurant that has a great reputation, as well as word of mouth that tells people how good it is, can be in a lower rental street or area, as the public will find it and come to it.

A quick serve restaurant, such as McDonald's or KFC, must be in a high impulse area, be it a food court, or a high exposure road.

Tip 4: Do you understand where your concept lies in terms of 'Impulse vs. Destination'? The higher the product is an 'impulse', the more important to be in a high exposure location.

Chapter 5: Friend or foe? Is Clustering Good or Bad?

Have you noticed that many fast food restaurants appear to group together, or that in most cases, the Telco stores are in a row (or in very close proximity)?

Our research over the years has shown that for most concepts, there is a definite advantage to be in a common locality. Our view is that if a cluster of fast food restaurants is built together, and if the total business each could have expected was $30,000 per week, then having four in a grouping will not generate a total of $120,000, but more like $140,000 per week.

"The total is greater than the sum of the parts" ... our view is that given choice, more people will come to the area to buy than the total patronage the individual sites would have attracted at separate locations. Have you ever wanted fast food, and the best way to solve the family's needs was to go to a "Cluster", so the kids could have McDonalds, and you could then have bought KFC or Pizza Hut?

Our view has been that in general, working in a cluster has been a "Friend" where as being 1km - 2km from a cluster of like-goods acts as a "Foe", as the power of the "Cluster" attracts more business away from you.

For years in the oil industry, there have been strips that are known as "gasoline alleys", and these have always had the reputation of discount petrol, and drawn people to them. Examples of this have been Canterbury Rd in Sydney, Ballarat Rd in Melbourne, and the Darlington strip in Adelaide.

A good deal of retail development at the moment is in building new Homemaker Centres, where like stores congregate, and attract people to the area with common needs of purchasing for their house. Many new Homemaker Centres, such as Peninsula Homemaker Centre at Mornington, are exceeding what both us and our clients expected to sell in the initial opening period.

The only exceptions (or where we have felt it diminishes) are where you are by far the strongest in the market, and you may be bringing competition to you, so that your competitors are essentially 'running off your coat tails'. A prominent example of where we have felt this to be occurring is with Telstra stores, where competitors such as Optus, Vodaphone and Orange benefit from the power, presence and market share that Telstra has.

Tip 5: It is normally far better to be in a cluster with your competition than out on your own, trying to draw customers to you. Think of being in a cluster as a friend, and on your own as a foe, as the power of the group is far stronger than the individual.

Chapter 6: Finding the Appropriate Sites in Shopping Centres

By now, you should have understood the concepts of finding the best area for your products. You also should now have considered if your goods or services are 'Impulse vs. Destination', and where they fall on the line.

In our view, there are different types of customers coming into a shopping centre, and you need to consider their needs. I believe the two ends of the spectrum are:

- The 'Quick' shopper (i.e.: the person who comes into the centre to go to the supermarket and the fresh food area). This person is buying their weekly needs, and will have little time or desire to wheel their goods around the centre browsing at other goods.

- The 'Retail Therapy' shopper (i.e.: the person who comes to the centre to browse for bargains, and look in many stores over a couple of hours). This is very common on weekends in the large Shopping Centres.

Some people are in between, but in a big centre, may have pre-conceived ideas of where they are going.

Large Shopping Centres tend to have precincts, and if your goods fall into a specific group, then it is often an advantage to be in the correct precinct. Examples of precincts we are starting to see are:

- Fast Food (i.e.: the Food Court of a shopping centre). This is the traditional area people gravitate to for lunch.
- Fresh Food (i.e.: often a precinct where you have vegetables / green grocers, butcher, fishmonger, hot bread shops, etc). Often it is adjoining the entrance to a supermarket.
- Fashion (i.e.: areas that attract the high-end fashion names). Many boutique fashion stores intermingle with the big names.
- Telcos (i.e.: telephone stores often gravitate together, normally as the smaller players have come to be near the Telstra store).
- General areas (i.e.: mixed business). These have many different tenants from the bookshops (such as Dymocks), Autobarn, ABC shops, Eyeware (such as OPSM) and many others. This normally contains all the stores where a separate precinct is not easily identifiable, plus being interlaced with clothing and fashion.
- The Cheap areas (i.e.: discount retailers). In the back or lower section of many shopping centres, you find the areas where there is low traffic, and the owners will take a low rent. Stores that need this low rent are often the $2 shops, rug shops, or stores selling to people as a "bargain". Often they need reasonable size but cannot afford much rent.

Being within a precinct can act as a Generator for your business. We look at many businesses as a 'Friend or Foe' situation, and if, for example, you are a Quick Serve Restaurant (i.e.: KFC, Ali Baba, McDonalds, etc), it is normally felt that you need to be in the Food Court, as this is where your customers come to. If you were a KFC out of the food court, with no other food options around you, you would not expect to do as well as being in the food court.

Tip - Look for Precincts in the Shopping Centre, and think how this will affect the business you are in. If possible, seek stores that bring your type of customer into the area.

Tip 6: Decide on the precinct you feel is most appropriate for you to operate. In large centres, look where that precinct is, and what opportunities are available in it. If it is a general concept, then look to where other general stores are operating, so they are also similar in the 'Impulse vs. Destination' ratio.

Chapter 7: Finding the Appropriate sites in Strips

Shopping strips vary in shape and size and the configuration depends on issues like parking and cross streets. Most strips have an identifiable "centre" and one of the best ways of seeing this is to look where the banks and supermarkets are located.

Strips are normally daytime activity centres, however there are strips that are night centres or food centres. Examples of these Australia would include Fitzroy St St Kilda (Melbourne), Oxford St Darlinghurst or Kings Cross in Sydney and the Northbridge precinct in Perth.

The normal daytime strip is active due to people shopping and visiting during the day. Some of the main areas you are able to see are:

- Banks – normally all located in a close area
- Market and fresh food
- Telecommunications – phone shops tend to congregate
- Newsagents and Chemists tend to be near the centre
- Outer, lower rental stores normally nearer the ends.
- Cafes and restaurants may be grouped or scattered throughout. If there is a theatre, then this will be a prominent part of a restaurant / café precinct.

If you are going into a strip, we believe you need to consider the 10 nearest stores as an indication of the precinct you are within. If you have 4 cafes or restaurants, then this is the sign that you are a restaurant precinct, or similar if 4 or 5 fashion or shoes stores.

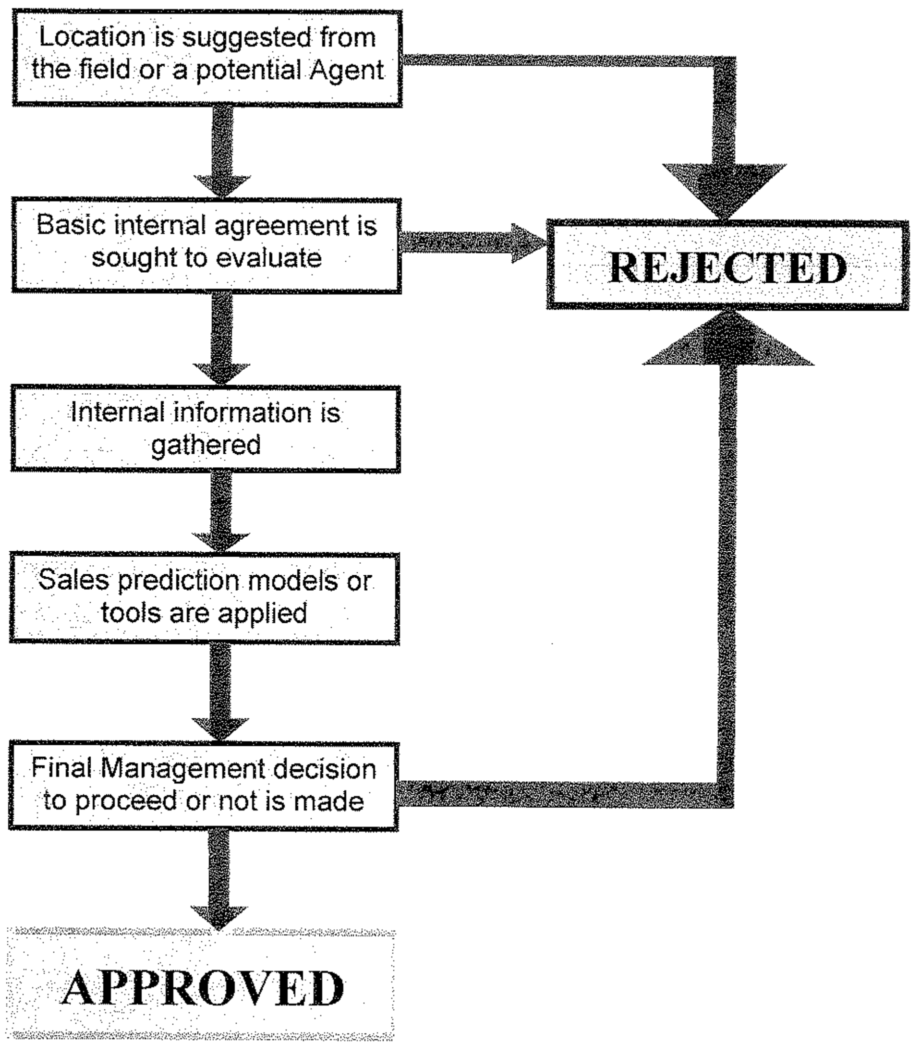
Look to what you are selling and see if there are precincts that will assist in being in the area.

Tip 7: Look for the precincts within the strip where you want your concept to be. Think of the 'day time vs. night time' traffic, and be aware of the different rentals the different precincts charge you.

Chapter 8 – Establishing a Process

It is essential that if you are building a retail network, you have a Process that you stick with in selecting stores.

My view is the simple overview can be shown by the following flowchart:



The way most property people think is probably quite similar to this, in that a site can either (a) be quickly eliminated, (b) be eliminated after some initial management consideration, or, once past these two hurdles, (c) undergo a rigorous examination, to decide whether to proceed or reject.

Most of our work occurs once a site has preliminary interest to being either approved or rejected.

Depending on the size of the existing network, we can decide what process we can apply to evaluate a potential new site. This ranges from looking at simply the demographics, to building a set on analytics that give sales predictions, based on certain factors that have been established (ideally by statistically evaluating the existing network).

For more details on this, please revisit our website and look at our published article - Sure Fire Site Selection.

Tip 8: Once you have a management approved process, it is extremely important that you are honest to yourself in applying it, and that you keep file records of the decision process, as well as the outcomes, so if you are challenged in the future, you can explain your process.

If you feel we can be assistance to you in working on establishing a Process for you, please contact us at Spectrum Analysis.

peterb@spectrumanalysis.com.au **or call us on Australia (03) 9815 0800**

Regards and best of success

Peter Buckingham
Managing Director
Spectrum Analysis Australia Pty Ltd

Appendix: Terms Used

GLAR – Gross Leasable Area Retail

Shopping centre term for how large a Centre is, based on the total area that is leased to retailers.

MAT – Moving Annual Turnover

12-month figure telling us the total dollars have been sold by all the retailers in a Centre.

Both the figures above are available through the Property Council of Australia in books they print and sell. The input for these comes from the shopping centre owners, who are normally members of the Property Council of Australia.

MAT figures are normally derived from the individual retailer's figures, as they normally have to disclose their sales to their Lessors as part of the lease conditions.