

Franchising Confidence Drops in July

Franchise Consultants' July 2015 *Franchising Confidence Index* reflects current general economic commentary by providing a less optimistic outlook this quarter across many key growth drivers, as reported by responding Franchisors and Service Providers.

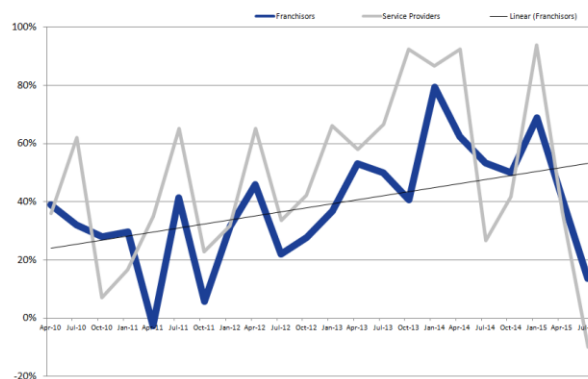
Franchisors still remain positive in their outlook for general business conditions (net 14%), access to financing (19%), sales levels per franchisee (32%), franchisee profitability levels (19%) and franchisor growth prospects (35%). Franchisors held a negative view on the availability of suitable franchisees (negative net 8%), suitable staff (-6%) and locations (-3%), and, operating costs per franchisee (net 16%).

Sentiment toward franchisee profitability, arguably a franchise system's key health and growth driver, decreased from a net 41% to 19%, as reported by responding franchisors – but still remains in positive territory. Service providers also were far less positive in their sentiment this quarter, reporting a net 0%.

The outlook for **general business conditions** is a key measure for this research because it can be compared with many other general business confidence surveys. Franchisors were still slightly positive (net 14%), albeit this is down from 41% in the last quarter. Service Providers were markedly down reporting negative net 10%.

We note the net 14% positivity experienced by franchisors is slightly higher than that of other research involving general business, including ANZ Business Outlook, which is now in the red (negative net 2% in June) and NZIER (5% in June) business confidence surveys.

GENERAL BUSINESS CONDITIONS



RESULTS SUMMARY TABLE *

	Franchisors												Service Providers											
	Jan-13	Apr-13	Jul-13	Oct-13	Jan-14	Apr-14	Jul-14	Oct-14	Jan-15	Apr-15	Jul-15	Jan-13	Apr-13	Jul-13	Oct-13	Jan-14	Apr-14	Jul-14	Oct-14	Jan-15	Apr-15	Jul-15		
General business conditions	37%	53%	50%	41%	79%	63%	53%	50%	69%	41%	14%	66%	58%	67%	92%	87%	92%	27%	42%	94%	36%	-10%		
Access to financing	13%	28%	9%	0%	9%	3%	13%	21%	41%	28%	19%	26%	46%	27%	14%	33%	38%	7%	42%	88%	36%	30%		
Access to suitable franchisees	5%	0%	9%	-13%	0%	-3%	17%	-17%	17%	17%	-8%	9%	38%	33%	29%	47%	8%	47%	33%	44%	55%	40%		
Availability of suitable staff	-5%	3%	3%	9%	3%	-19%	-7%	-17%	-18%	-7%	-6%	13%	17%	27%	29%	13%	-15%	-7%	0%	6%	0%	30%		
Availability of suitable locations	-5%	0%	13%	19%	0%	7%	-8%	-17%	12%	7%	-3%	31%	33%	20%	14%	40%	8%	7%	8%	27%	9%	20%		
Sales levels per franchisee	32%	56%	53%	53%	65%	66%	70%	63%	62%	38%	32%	44%	54%	60%	50%	80%	85%	40%	50%	80%	45%	10%		
Operating costs per franchisee	-11%	-11%	-16%	-16%	-18%	-6%	13%	-38%	-3%	-10%	-16%	-4%	-17%	-20%	-7%	-40%	-46%	-33%	-25%	6%	-9%	-20%		
Franchisee profitability levels	13%	44%	28%	19%	38%	50%	53%	17%	38%	41%	19%	30%	25%	53%	36%	60%	31%	7%	18%	40%	55%	20%		
Franchisor growth prospects	41%	58%	53%	50%	62%	41%	63%	38%	57%	59%	35%	61%	67%	67%	79%	93%	69%	27%	50%	80%	27%	0%		

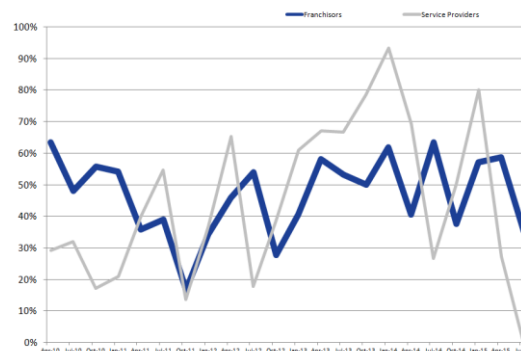
*The figures indicate 'net' confidence. Net' confidence is the difference between those reporting 'better' and 'worse'

Franchisor sentiment for **franchisor growth prospects** decreased to a net 35% - down from the previous quarter (net 59%). Service Providers perceptions were also significantly down from last quarter's result of 27% to 0%.

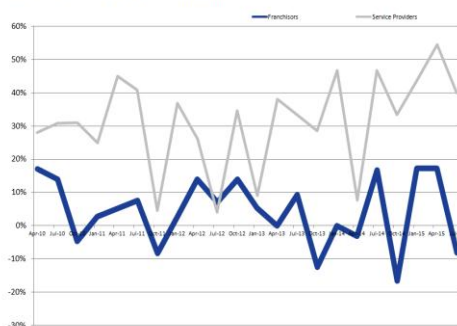
Franchisor sentiment toward access to suitable franchisees was also down this quarter at negative net 8%. Service Providers were more positive at 40%.

Franchisor sentiment toward access to financing also decreased slightly from 28% to 19%. Service Providers were also less positive reporting 30%, a slight decrease from 36% in the last quarter.

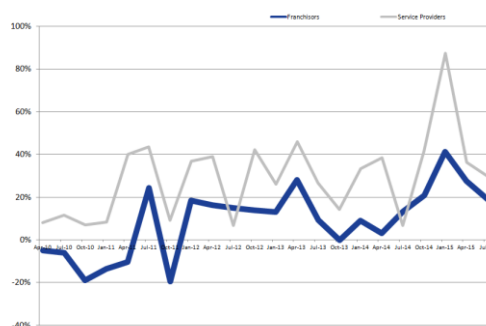
FRANCHISOR GROWTH PROSPECTS



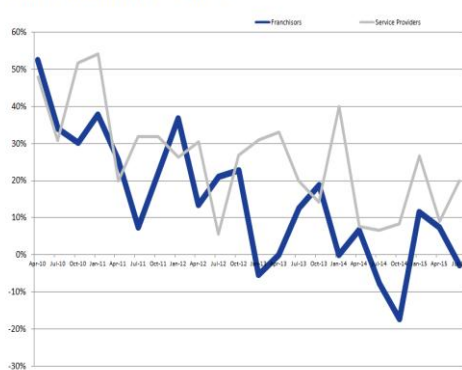
ACCESS TO SUITABLE FRANCHISEES



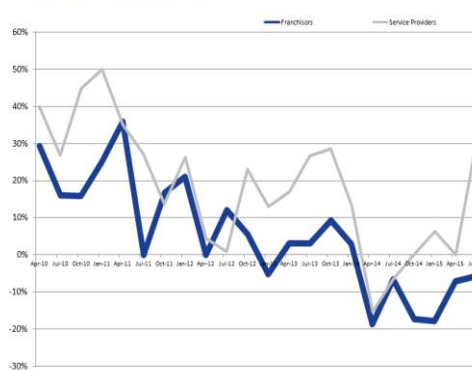
ACCESS TO FINANCING



ACCESS TO SUITABLE LOCATIONS



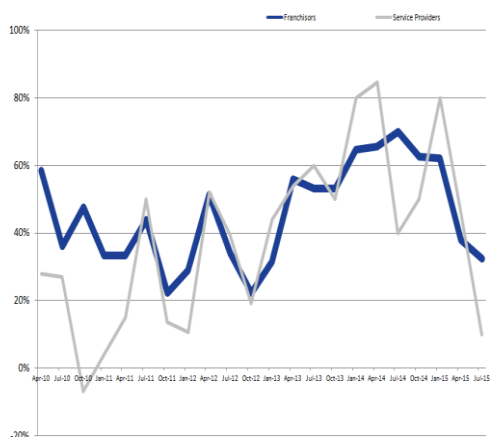
ACCESS TO SUITABLE STAFF



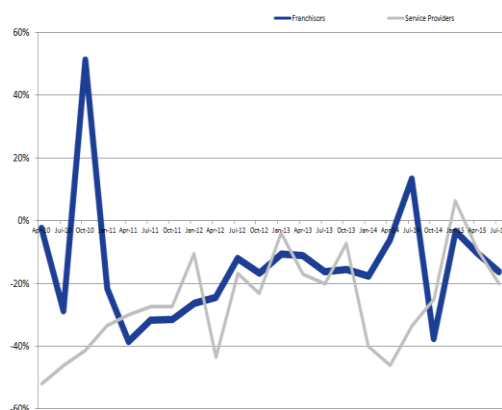
Franchisors were less optimistic this quarter in their outlook for access to suitable locations at a negative net 3%, Service Providers were more positive at net 20%. Franchisors were also subdued in their sentiment toward the availability of suitable staff, reporting negative net 6%.

Net Franchisor (32%) and Service Provider (10%) sentiment toward future franchisee sales levels were also down from the last quarter. Franchisor outlook on franchisee operating costs remained lower at negative net 16%. Service Providers also lower reporting negative net 20%.

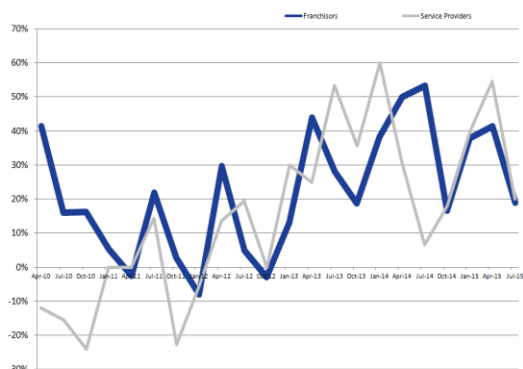
SALES LEVELS PER FRANCHISEE



OPERATING COSTS PER FRANCHISEE



FRANCHISEE PROFITABILITY LEVELS



This quarter, both Franchisors and Service Providers reported a decrease in positivity toward franchisee profitability levels, at a net 19% and 20%, respectively.

Franchising Outlook

Franchisors were asked for qualitative responses on how things were looking in their sector. Eleven franchisors responded, mostly with positive comments. Positive franchisors included those in the building and construction industry, and related services and cleaning services. The following examples are indicative of this sentiment:

- *"Still growing with more confidence"*
- *"Material contract cutting services - cost of machinery has seen a large increase (large part of our franchise business) which will affect profitability and growth"*
- *"Vending - seems to be pretty good generally - no complaints"*
- *"Cleaning Services: things solid but customers always very price focused. Potential for further Regional growth"*
- *"Very similar to last year but as my franchise network matures I expect a better result in their profitability levels"*
- *"Bulk landscape and garden supplies. Becoming more competitive in our sector, but we expect to see 10% growth this year store on store"*
- *"Construction. Auckland continues to be strong. Christchurch slowing markedly. Regions being affected by dairy payout"*
- *"Generally better. Health and well-being is still important to the population even in difficult times"*
- *"Our sector is very buoyant especially around on line retail opportunities"*
- *"Automotive Paint Repair: People are still cautious but Fx rates will increase new car prices which benefits us. Dealerships looking for value added which again fits our model"*
- *"A general business upswing but for how long?" Supplier*

Service Providers were similarly asked how they thought things were looking for franchisors and franchisees. Their responses were varied. Key examples include:

- *"I think we will see a slow down in the food/hospo sector in Auckland as there seems to be an over saturation of food brands. In Auckland, I think we will see increased operating costs and reduced profits for franchisees coming off the back of the property market with vacant retail locations being snapped up pretty quickly of late and landlords increasing rents at rent reviews which, in our experience for retail, seem to either be at fixed annual increases of around 4% and others deferring to market reviews at the 2 yearly mark . I think we may see some franchisees getting unstuck in the coming years with crushing rental overheads (in Auckland) and that will in turn lead to increased supply of retail locations. I think the presence of international students will assist in creating a generous labour supply. I think that there is some potential uplift for increased consumer spending as a result of the reduced strength of the NZD but suspect that will likely be isolated to the regions on the back of increased labour demand of our exporters (except in dairy which has low labour requirements anyway). I think the regions will benefit more than Auckland"*
- *"Uncertain- market dependent"*

- *“Too much emphasis on dairy sector will affect sentiment in the rest of the economy, although this should be offset by lower interest rates and in some cases lower kiwi”*
- *“Population growth should lead to improved availability of staff and franchisees. Very low financing costs & increasing housing equity should improve access to finance”*
- *“Systems are growing stronger than at any time since 2007. Equity is available and confidence to invest in businesses lead to better conversion”*

Concluding Comment

Franchising sentiment has dropped in July, which should not be a surprise given the economic backdrop and the view of many economic forecasts variously noting headwinds and challenges. Examples of negative drivers are the impact of falling (and potentially low sustained) dairy prices, a possible peak in the Canterbury rebuild stimulus, and global economic uncertainties.

Not surprisingly, Franchise Consultants’ Franchising Confidence Index in July 2015 demonstrates a more subdued outlook than the previous quarter. Although confidence is down from the extremely high levels reported last year, franchisors and service providers do remain reasonably optimistic.

As reported, franchisors, on balance, still remain positive in their outlook for general business conditions, access to financing, sales levels per franchisee, franchisee profitability levels and franchisor growth prospects – although outlook for general business conditions deteriorated most (i.e. from 41% to 14%).

Meanwhile, franchisors held a negative toward the availability of suitable franchisees, suitable staff and locations, and, operating costs per franchisee.

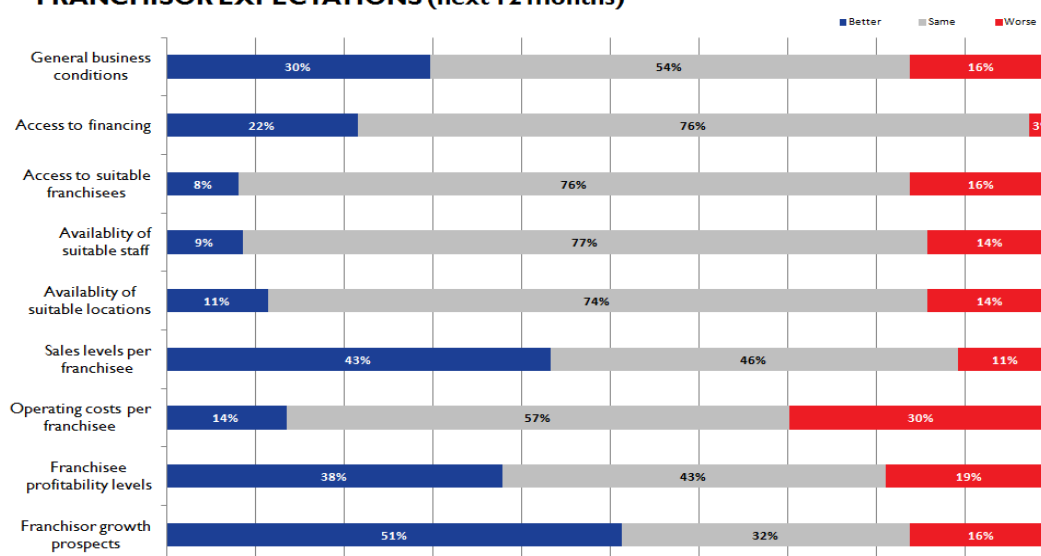
Importantly, overall, net franchisor sentiment for future franchisee profitability was positive – but reduced.

Franchise Consultants is of the view that franchisors should be including challenged scenarios within their forward planning, including forecasts on sustainability. At the same time, all viable initiatives should be considered and undertaken at this time to ensure a solid franchise structure and system is in place, key franchising processes are optimised, and support staff and franchisee capability and execution is continually developed.

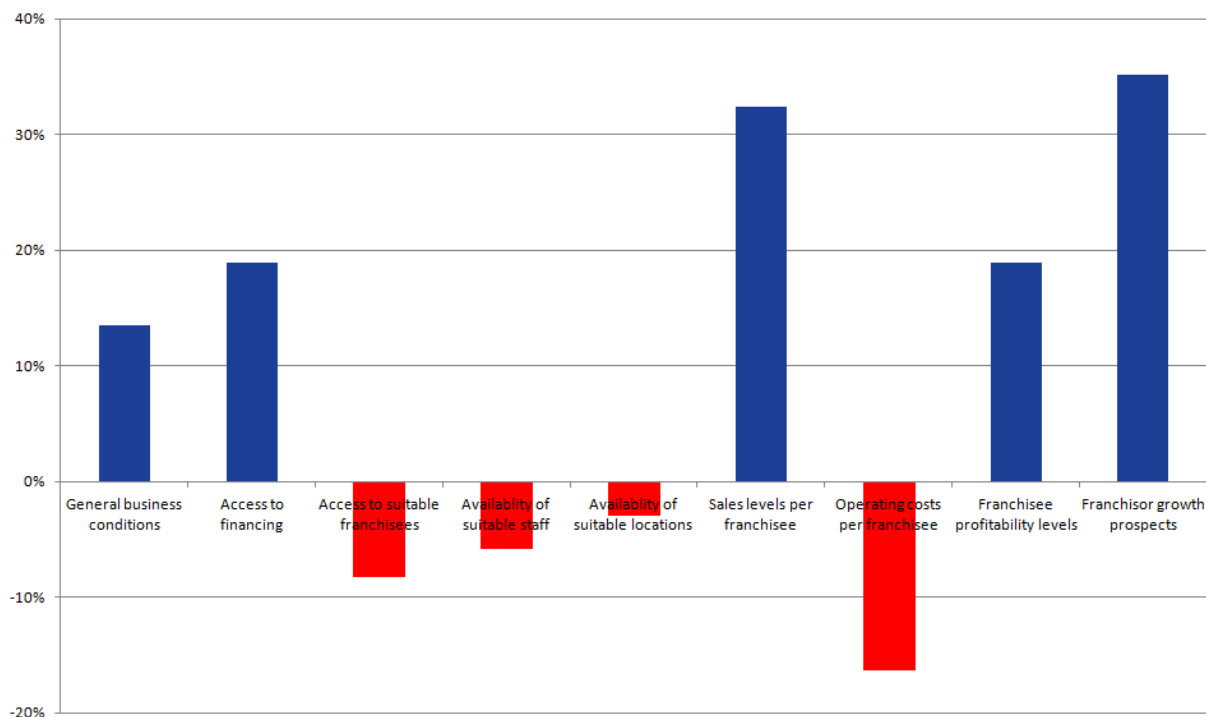
FRANCHISING CONFIDENCE CHARTS

The following four illustrations present individual and net franchisor and Service Provider expectations (separate charts) for the following year across all questions, including general business conditions and franchisor growth prospects (covered above).

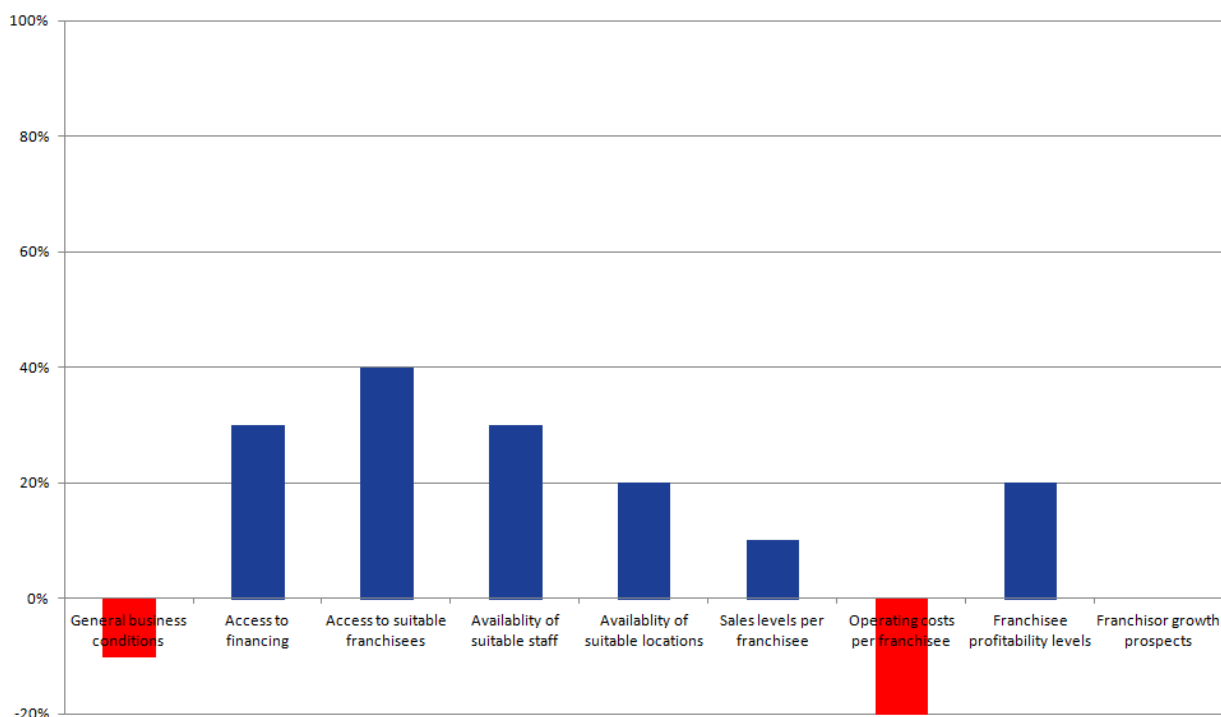
FRANCHISOR EXPECTATIONS (next 12 months)



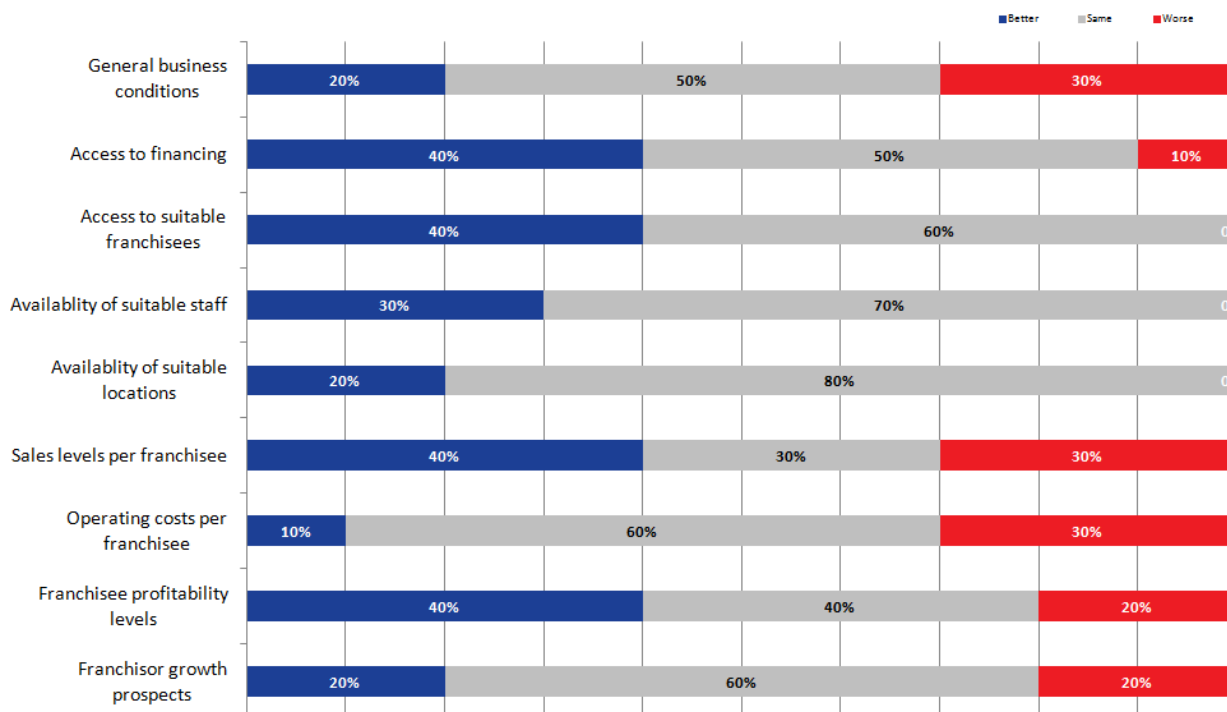
NET FRANCHISOR EXPECTATIONS



NET SERVICE PROVIDER EXPECTATIONS



SERVICE PROVIDER EXPECTATIONS (next 12 months)



Franchising Confidence Index

The Franchising Confidence Index represents the views and expectations of franchising, an important domain of business within the New Zealand economy.

Franchising is a substantial and growing domain of business making up an important part of the New Zealand economy. The *Franchising New Zealand 2012* survey, conducted by Massey University in collaboration with Griffith Business School, indicates New Zealand has 446 individual franchise systems comprising some 22,400 units (owned mostly by franchisees). The survey also suggests local franchise systems employ some 100,000 people. Finally, local expert estimates of total franchise system turnover range from \$15 to \$25 billion – suggesting franchising is a strong contributor to New Zealand GDP – as it is around the world. Companies involved in franchising are as diverse as Foodstuffs (New World, PAK'nSAVE, Four Square), NZ Post, Fisher & Paykel, Contact Energy, McDonald's, Columbus Coffee, Fastway Couriers, Harcourts and Fletcher Building.

The Franchising Confidence Index represents confidence in key measures critical to the success of franchising in this country by reporting attitudes toward general business conditions, as well as key franchising growth determinants including access to capital, suitable potential franchisees, staff and locations. The Franchising Confidence Index also covers franchising health attributes and outcomes by exploring franchisee sales, operating costs and profitability, and franchise system growth prospects.

The data and analysis presented represents the views of 37 franchisors and 10 Service Providers collected between Monday 13th July and Friday 24th July 2015. Findings from both groups are reported separately.

Respondents were asked whether they expected conditions to be 'better,' 'same' or 'worse.' 'Net' confidence is the difference between those reporting 'better' and 'worse.'

The data and analyses were compiled by Shelley Cross.

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Franchising Confidence Index

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