

Franchising Sentiment Positive, But Growth Constraints Emerge

Franchise Consultants' April 2017 *Franchising Confidence Index* demonstrates a positive outlook overall on many key areas of sentiment (e.g. general business conditions, franchisor growth and franchisee profitability). Meanwhile, however, concerns emerge for key growth enablers, including access to finance, access to suitable franchisees and availability of suitable staff.

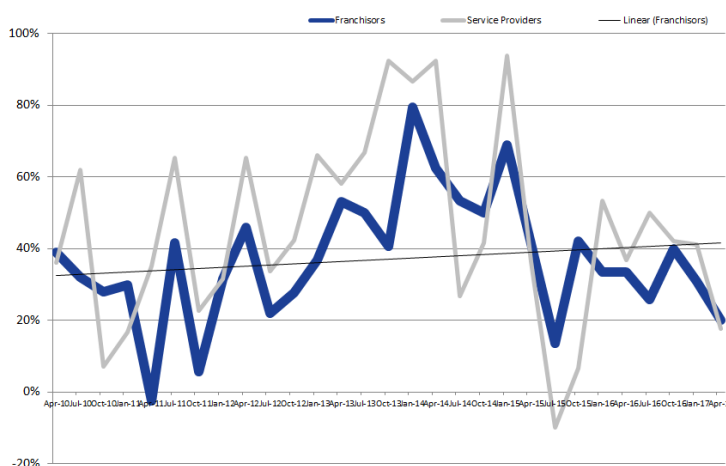
Franchisors remain positive but more subdued in their outlook for **general business conditions** (net 20%), down from a net 31% the previous quarter. Service Providers, were of a similar opinion with a drop from net 41% to a net 18%.

Whilst the numbers show a decline, both franchisors and service provider comments remain quietly positive.

The franchisor net 18% decline in outlook for general business conditions is in line with other research involving general business. The ANZ Business Outlook decreased to a net 11% in March (from 22% in January). Meanwhile, the NZIER business survey improved from a net 13% in January to 16% in April.

Our experience now over 29 quarters (or more than six years) indicates franchisors are often more positive toward future general business conditions compared to datasets involving other organisational forms.

GENERAL BUSINESS CONDITIONS



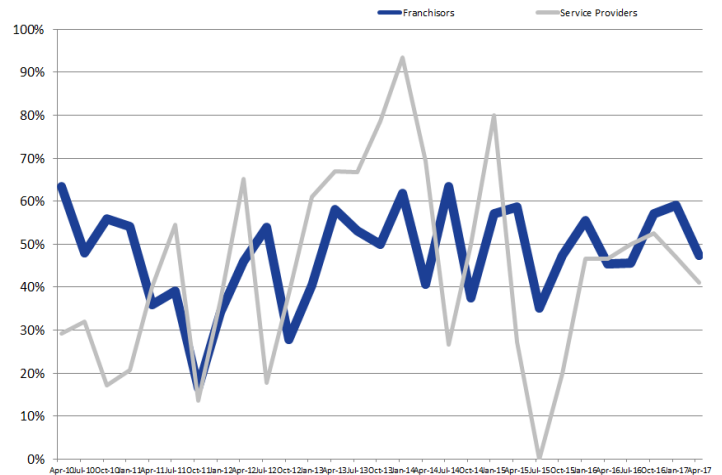
RESULTS SUMMARY TABLE

	Franchisors								Service Providers							
	Jul-15	Oct-15	Jan-16	Apr-16	Jul-16	Oct-16	Jan-17	Apr-17	Jul-15	Oct-15	Jan-16	Apr-16	Jul-16	Oct-16	Jan-17	Apr-17
General business conditions	14%	42%	33%	33%	26%	40%	31%	20%	-10%	7%	53%	37%	50%	42%	41%	18%
Access to financing	19%	21%	30%	21%	0%	15%	-8%	-18%	30%	27%	53%	37%	-5%	0%	18%	0%
Access to suitable franchisees	-8%	-16%	0%	-6%	11%	12%	10%	-10%	40%	33%	20%	21%	5%	21%	41%	24%
Availability of suitable staff	-6%	0%	-7%	-9%	-12%	-13%	-3%	-26%	30%	0%	0%	11%	5%	-5%	-6%	0%
Availability of suitable locations	-3%	-6%	-16%	3%	6%	-13%	16%	17%	20%	20%	0%	53%	5%	26%	12%	6%
Sales levels per franchisee	32%	53%	52%	39%	51%	63%	56%	49%	10%	7%	53%	-21%	30%	42%	53%	41%
Operating costs per franchisee	-16%	-6%	-19%	3%	-6%	0%	-13%	0%	-20%	-7%	20%	26%	5%	-11%	0%	-29%
Franchisee profitability levels	19%	26%	44%	21%	40%	49%	44%	40%	20%	27%	33%	47%	40%	21%	35%	0%
Franchisor growth prospects	35%	47%	56%	45%	46%	57%	59%	48%	0%	20%	47%	47%	50%	53%	47%	41%

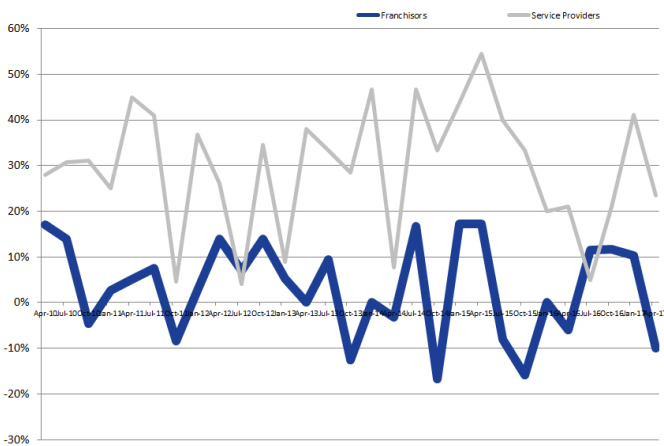
*The figures indicate 'net' confidence. Net' confidence is the difference between those reporting 'better' and 'worse'

Franchisor sentiment for **franchisor growth prospects** remain very strong, albeit dipping to a net 48% from 59% in January. Service Providers also indicate positive franchisor growth prospects overall.

FRANCHISOR GROWTH PROSPECTS



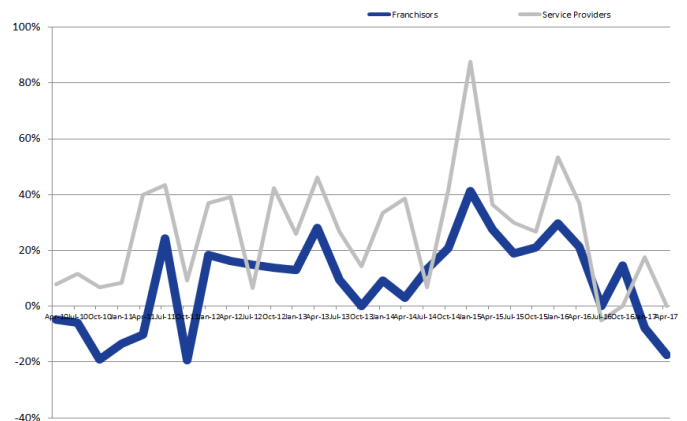
ACCESS TO SUITABLE FRANCHISEES



Franchisor sentiment toward access to suitable franchisees reflects the challenge and can change quite significantly quarter to quarter. Franchisors saw a drop from net 10% to net negative 10%, with Service Providers, who last quarter were very positive at net 41% dropping to net 24% this quarter.

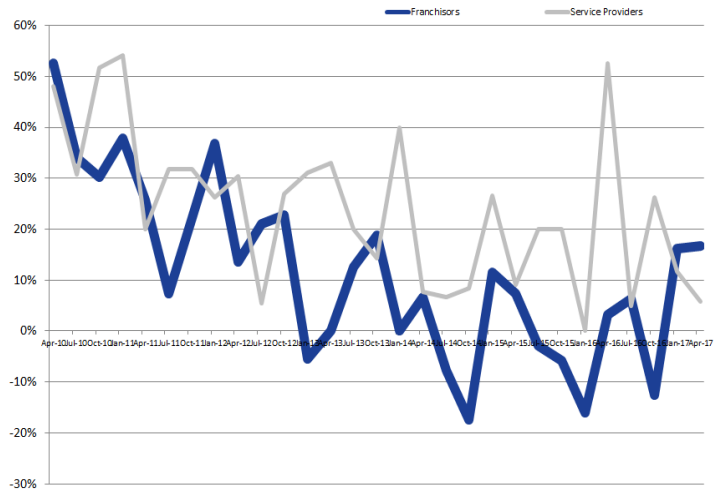
Franchisor and Service Provider sentiment toward access to financing appears to be tightening with franchisors dropping from net negative 8% to net negative 15%. Service Providers dropped in net sentiment from a positive net 18% to 0% this quarter. Access to financing is crucial for franchisors, as franchisees invariably require bank funding. Sustained reductions in perceived access to financing is of concern to the franchise community.

ACCESS TO FINANCING



Access to suitable locations often provides quite a fluctuating picture however this quarter remained relatively stable with franchisors showing a net 17%, up from net 16%. Service Providers sentiment was slightly more sombre down from net 12% to net 6%.

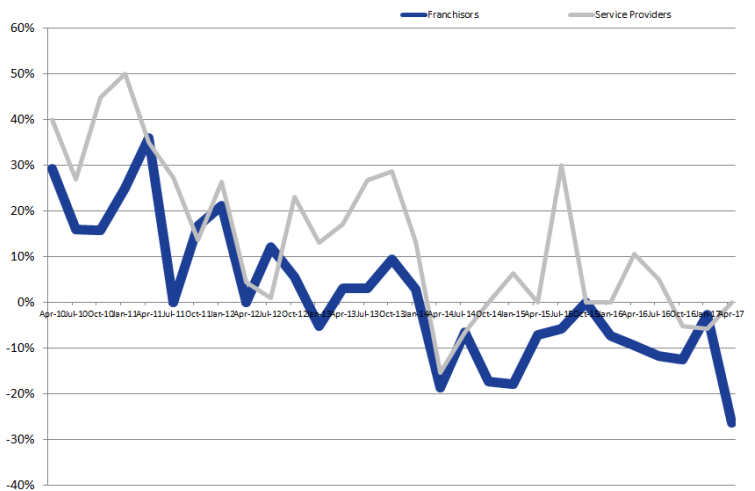
ACCESS TO SUITABLE LOCATIONS



Franchisors sentiment toward the availability of suitable staff hit the lowest point seen during the time of this research at net negative 26%, down from net negative 3%. Service Providers were, in comparison, more positive than last quarter up 6% to a net 0%.

This area has been seen as a challenge for some time and is now hitting a little harder in certain areas.

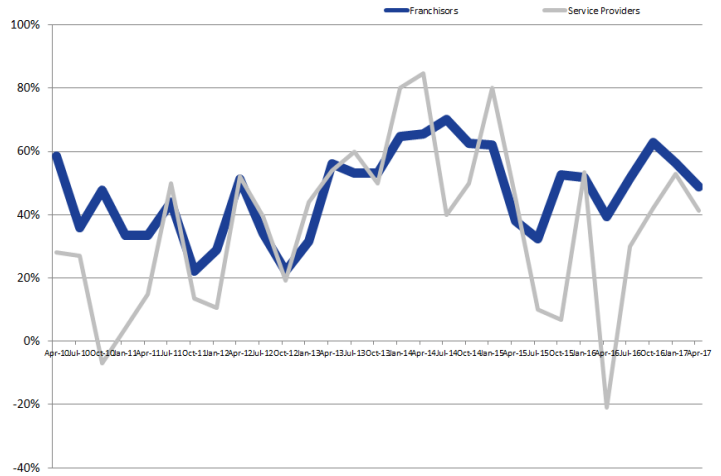
ACCESS TO SUITABLE STAFF



The Franchisee Picture

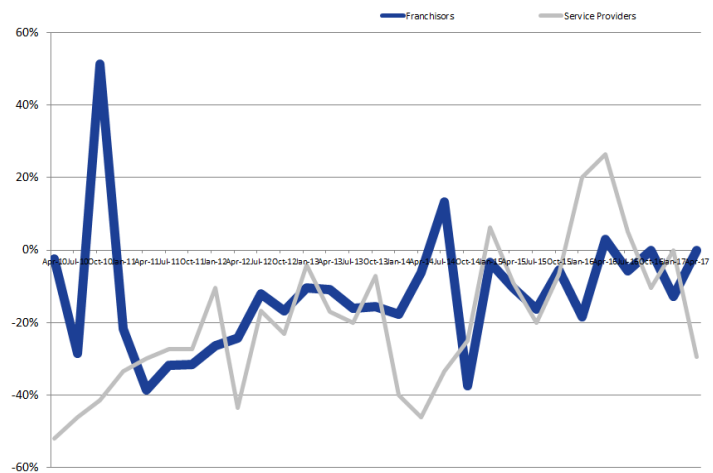
Whilst both Franchisor and Service Provider sentiment for franchisee sales levels remain at inflated levels, there was a slight drop this quarter, with Franchisors decreasing from a net 56% to net 49%. Service Providers, were slightly less positive than Franchisors showing a decrease from a net 53% to a net 41%.

SALES LEVELS PER FRANCHISEE



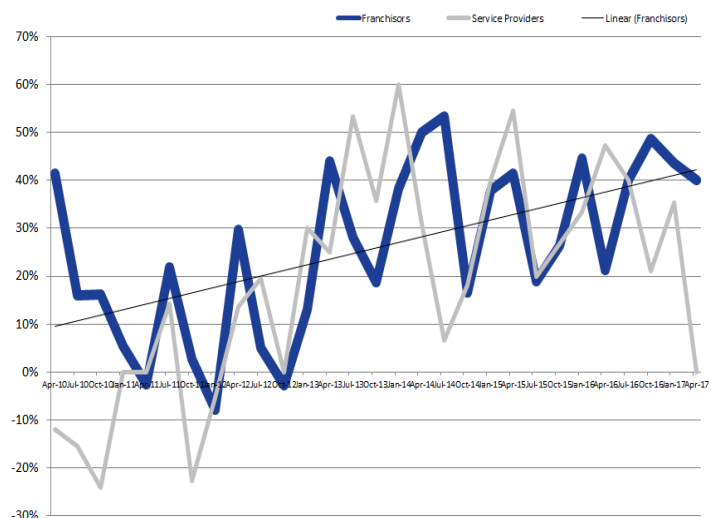
As historically demonstrated Franchisors and Service Providers views of operating costs in April continues to move in opposite directions. Franchisors sentiment this quarter increased from net negative 13% to net 0%, whereas Service Providers sentiment has taken a large dip decreasing from net 0% to a net negative 29%.

OPERATING COSTS PER FRANCHISEE



Finally, sentiment toward franchisee profitability levels remained quite stable for Franchisors down from a net 44% in January to a net 40% in April. Service Providers sentiment by contrast dipped substantially from a net 35% to a net 0%.

FRANCHISEE PROFITABILITY LEVELS



Franchising Outlook

Franchisors were asked for qualitative responses on how things were looking in their sector. Twenty useable responses were received with a mixture of sentiment – reflecting the results outlined above. Some positivity, by sector, is palpable, with examples, being property management, beauty, car valet and some unspecified industries. Such positive sentiment variously referred to sales demand, demand growth and profitability. Some neutral and negative sentiment was also noted across a range of sectors – as indicated below. Less positive responses (often individual) included references to a very competitive market, staffing, reduced access to suitable finance and areas slowing down or tightening.

The following examples are indicative of this sentiment:

- *Property Management thrives when real estate sales are slow, and they appear to be slowing down.*
- *Beauty Industry, very positive*
- *Our sector of retailing books and gifts remains competitive and for that reason we believe conditions are likely to remain neutral*
- *Difficult time of change and business model in our sectors. Some franchisees can adapt, some can't. Information technology*
- *Very competitive market place*
- *Car and marine grooming – more competition and price cutting from people who think they can operate solely but all they do is take business away from reputable businesses and then within 2 years they are gone. The only pool of potential franchisees tend to be new immigrants. Business returns depend largely on the amount of marketing you have.*
- *Rural we have held well based on the poor recent mill payout and stress on farmers*
- *Retail and financial services products. Access to banking and finance products for franchisees are the barriers to growth*
- *Business advisory. No change*
- *Liquor retail. With the new laws, our franchisees rely on overseas employees. The new law focuses on upskilling Kiwi's which is great, just not for our sector as it will cost them more to assist with getting PR status and keep them employed. Personally I agree, just a hindrance for our franchisees until they get used to it. So it will be worse before is gets better.*
- *Strong growth in retail property management*
- *We are growing, we are franchisors in Australia*
- *Things are mostly positive, with a small level of growth predicted. Our franchisee businesses are growing and profitable*
- *About to go gangbusters, mobile car valet*
- *Immigration is still a driver for retail but only in the cities. The provinces are static or going backwards.*

- *Retail. We had a great first 6 months but the last 6 months has certainly come back by around 6%. We are hoping for a good start to the new financial year*
- *Commercial cleaning. There has been a downturn in trade for our hospitality clients and is a trend that we are likely to continue to see as we head into winter. Many decision makers are opting to centralise their cleaning requirements with idle staff*
- *Hospitality – costs are tightening and so we are having to think of more efficient and effective ways to ensure franchisees return the same or better profitability*
- *We are seeing more franchise enquiries lately with interest coming from people looking at lifestyle option being their own boss. Our market is currently strong with good sales.*
- *Things are mostly positive, with a small level of growth predicted. Our franchisees businesses are growing and profitable.*

Service Providers were similarly asked how they thought things were looking for franchisors and franchisees. Their responses were generally cautiously positive, with some indicating potential slowing growth. Key examples include:

- *Positive growth, growing economy. Money is cheap. Morale is good*
- *Anecdotal evidence of increases in operating costs and less profitability*
- *Franchisor growth rate will likely slow down from the growth achieved during the past 2 years owing to construction lead time delaying the availability of new suitable locations, perceived tightening in bank lending and an increase in wage expectations following a sustained period of low wage inflation. Growth is still supported by availability of staff and improving availability of suitable potential franchisees*
- *Generally very good*
- *Confident and lots of action – both should be happy and just ignore election year*
- *Franchisees in many industries (but not all) are very profitable at the moment -the best in a long time. General conditions may tighten somewhat in the next 12 months, after a good cycle*
- *Pretty good, seems to be an increases level of interest*
- *Mixed. Growth in some sectors, uncertainty in others*

Concluding Comment

Franchise Consultants' April 2017 *Franchising Confidence Index* demonstrates a positive outlook overall on many key areas of sentiment. Sentiment toward franchisor growth and franchisee profitability remain very positive overall, albeit slightly reduced compared to the previous quarter. Sentiment toward general business conditions also remain in good positive territory, albeit also reduced.

Meanwhile, however, concerns emerge for key growth enablers, including access to finance, access to suitable franchisees and availability of suitable staff.

Sentiment toward access to finance has reduced and this is a concern for the franchise community. Some banks do appear to be reducing their marketing focus on franchising, and banks generally are becoming more selective (often for good reason) in their lending decisions.

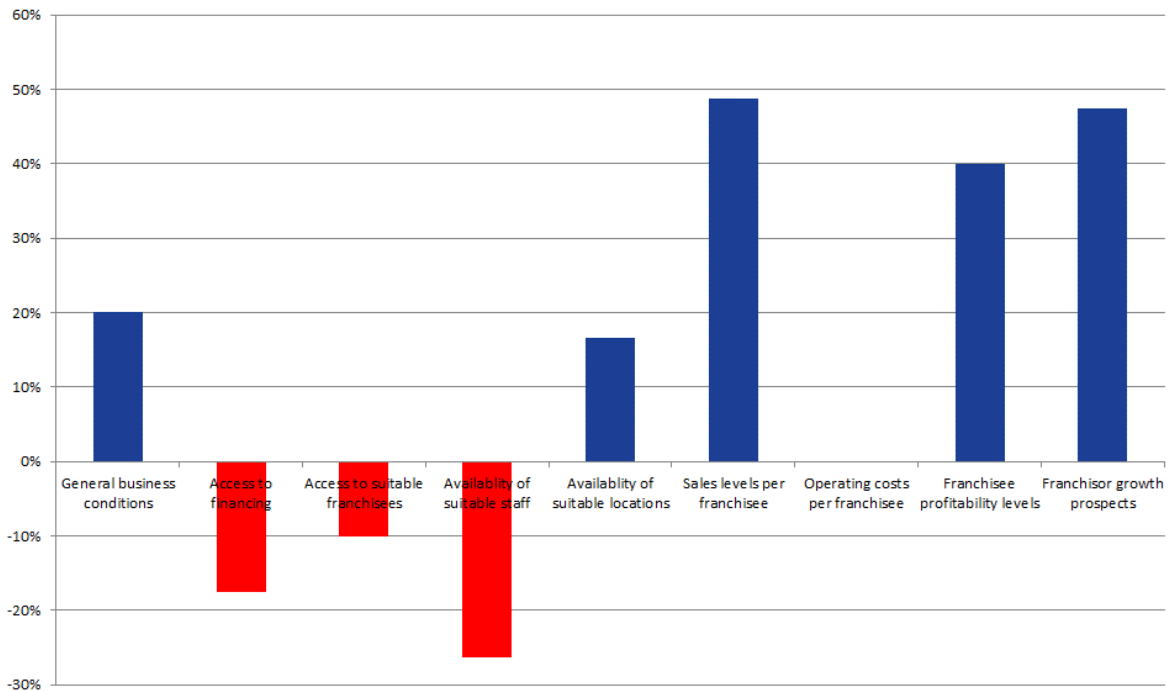
Also noteworthy is the reduction and record low level of sentiment toward the availability of suitable staff. This again is of concern because it reduces the ability of both franchisees and franchisors to take advantage of demand potential.

Overall, there is a positive based sentiment toward the future. However, there are concerns in some areas and there is some concern the economic future is becoming less certain. Aligned, as is commonly our view, Franchise Consultants view is that now, particularly when there is some buoyancy, is a time to evaluate franchise system structure and performance for future improvement needs and opportunities.

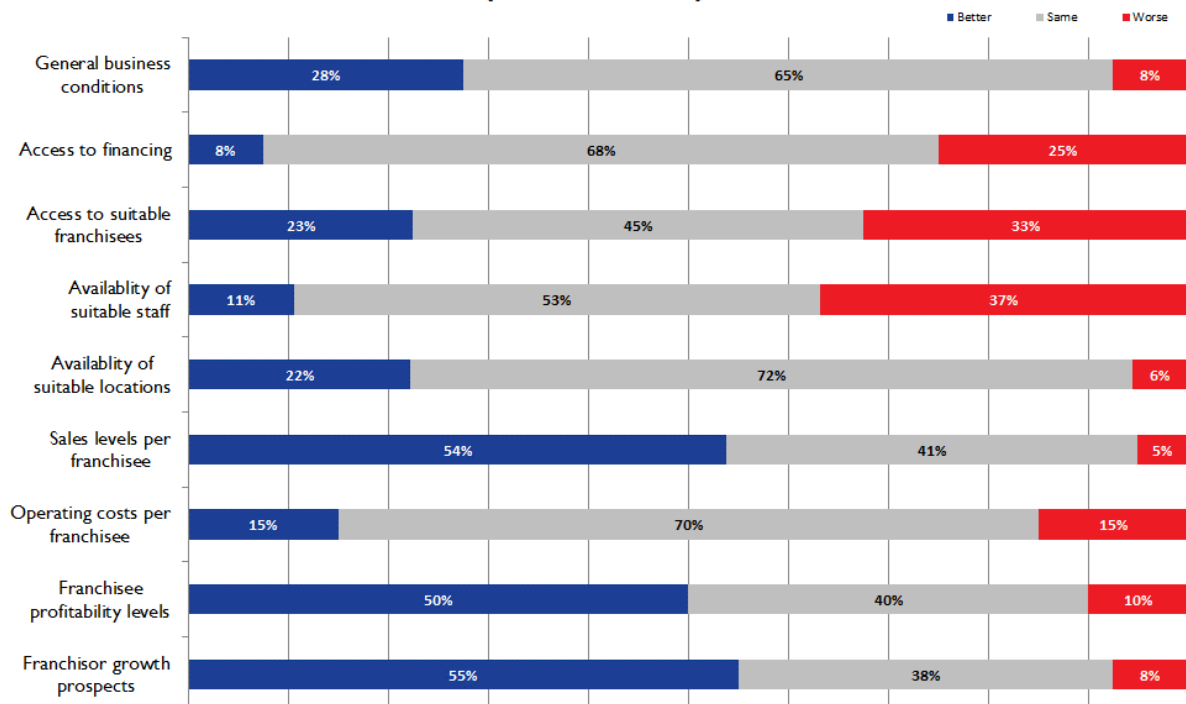
FRANCHISING CONFIDENCE CHARTS

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

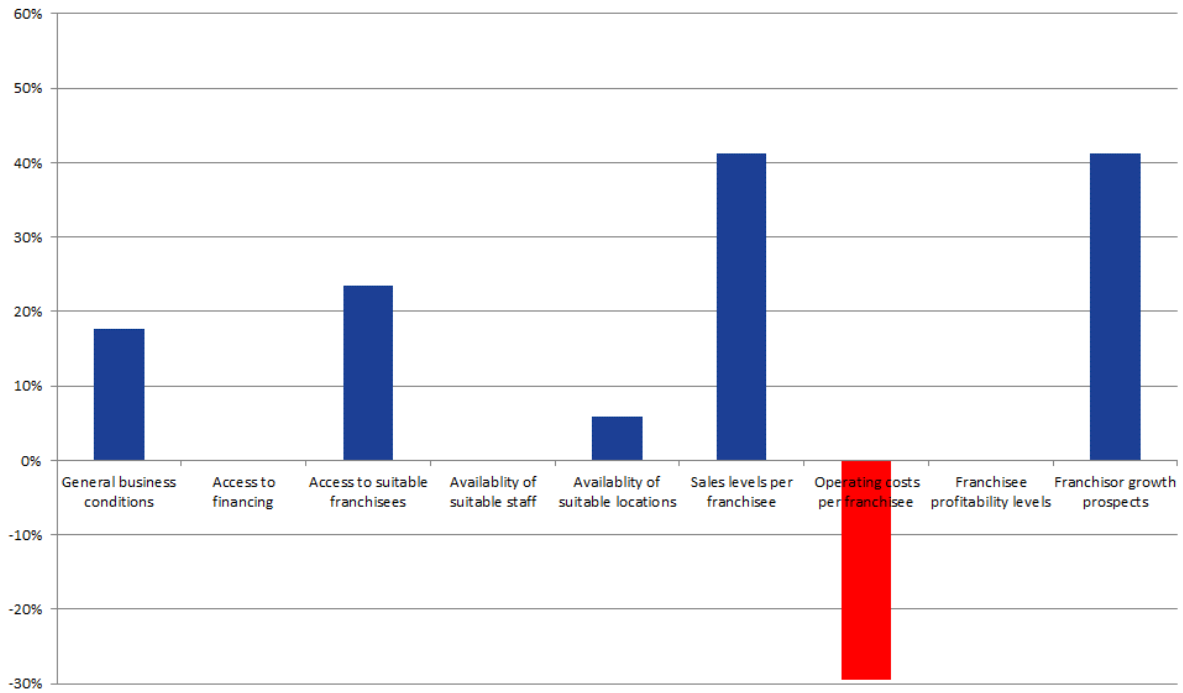
NET FRANCHISOR EXPECTATIONS



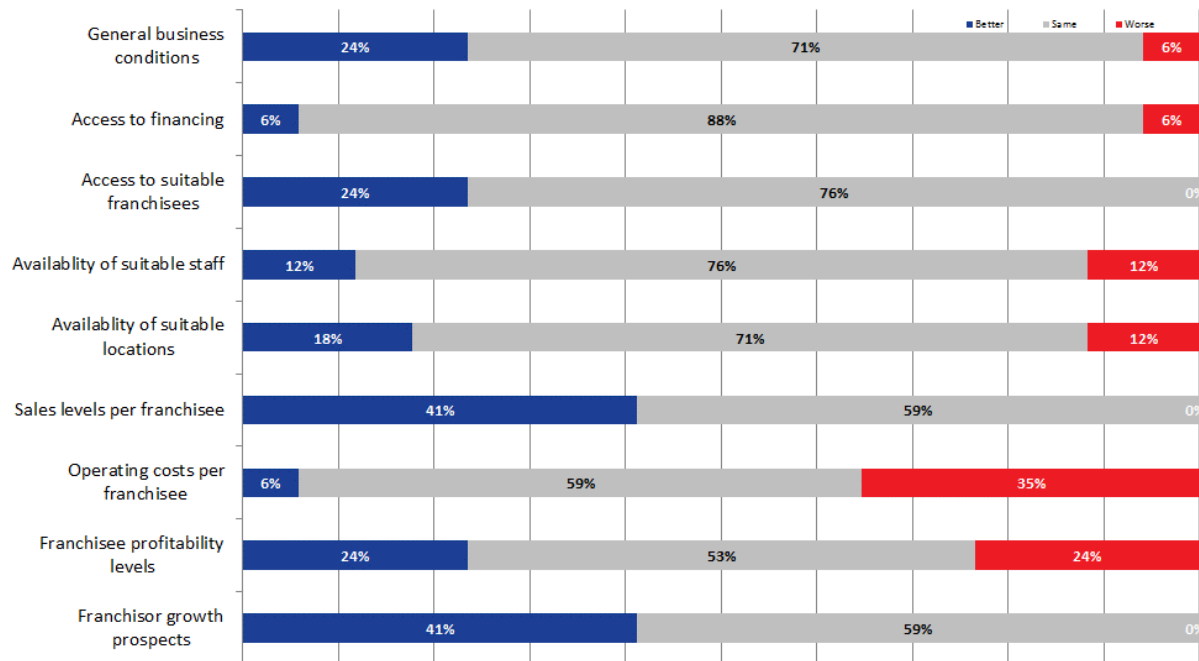
FRANCHISOR EXPECTATIONS (next 12 months)



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 40 Franchisors and 17 Service Providers collected between Monday 3 April and Friday 7 April 2017. 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 results were compiled by Kayleen Smith, Business Support Manager, Franchise Consultants.

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