

Franchising Starts 2019 With a Hint of Optimism

Franchise Consultants' January 2019 *Franchising Confidence Index* indicates the subdued sentiment of the past few quarters may be cautiously turning with sentiment levels across a number of areas lifting compared to the previous quarter. General business conditions, access to suitable franchisees, operating costs per franchisee and franchisor growth prospects, whilst still showing negative sentiment, all indicated some improvement compared with the previous quarter. Meanwhile, declines were noted for access to suitable staff and availability of suitable locations.

Franchisor outlook for general business conditions (negative net 3%) moved closer to the January 2018 sentiment of net 3%, (up from net negative 22% in October 2018) whilst Service Providers sentiment rose substantially to net 19%, similar to that seen in October 2017 (net 13%) prior to the change in government (up from net negative 23% in October 2018).

The Franchisor outlook for January 2019, whilst still lower in some areas than that of January 2018, is showing the tide may well

be starting to turn. Access to suitable franchisees saw a positive shift to net negative 24%, up from a net negative 28%, with sales per franchise net 26% (compared to net 28%) and franchisor growth prospects net 21% (compared to net 23%) showing similar results albeit they have been up and down during the year. Service Providers indicated they were more positive across 50% of the categories when compared with sentiment from January 2018.

The general business conditions outlook of net negative 3% was, as our experience indicates, stronger than other research involving general business. The ANZ Business Outlook showed improvement at net negative 24% in December from net negative 38% in October 2018. NZIER similarly saw an improvement at net negative 18% compared to net negative 28% in October.

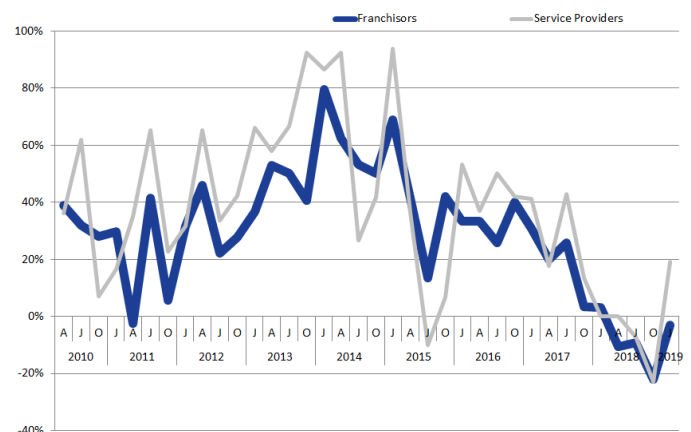
Our experience, now charted over 36 consecutive quarters (since April 2010), indicates franchisors are normally more positive toward future general business conditions compared to other datasets involving other organisational forms.

RESULTS SUMMARY TABLE *

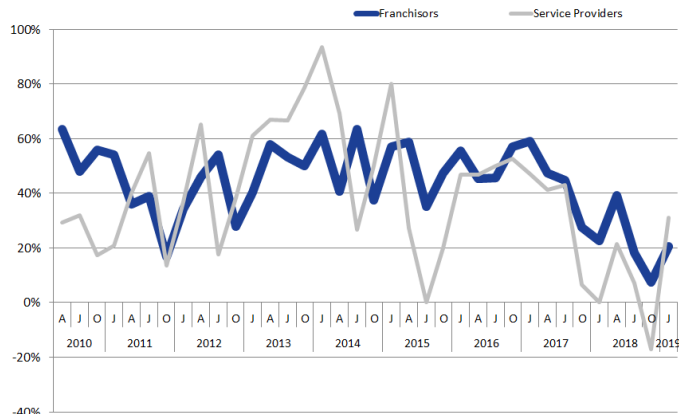
	Franchisors												Service Providers																			
	2016				2017				2018				2019				2016				2017				2018				2019			
	J	A	J	O	J	A	J	O	J	A	J	O	J	A	J	O	J	A	J	O	J	A	J	O	J	A	J	O	J	A	J	O
General business conditions	33%	33%	26%	40%	31%	20%	26%	3%	3%	-11%	-9%	-22%	-3%	53%	37%	50%	42%	41%	18%	43%	13%	0%	0%	-7%	-23%	19%						
Access to financing	30%	21%	0%	15%	-8%	-18%	-8%	-13%	0%	-21%	0%	-30%	-18%	53%	37%	-5%	0%	18%	0%	-21%	-7%	7%	14%	7%	0%	-6%						
Access to suitable franchisees	0%	-6%	11%	12%	10%	-10%	13%	-20%	-28%	-14%	-36%	-48%	-24%	20%	21%	5%	21%	41%	24%	36%	7%	7%	0%	-21%	-15%	0%						
Availability of suitable staff	-7%	-9%	-12%	-13%	-3%	-26%	-32%	-14%	-16%	-22%	-34%	-31%	-31%	0%	11%	5%	-5%	-6%	0%	-7%	7%	0%	-50%	-43%	-31%	-38%						
Availability of suitable locations	-16%	3%	6%	-13%	16%	17%	-5%	11%	7%	4%	0%	13%	-3%	0%	53%	5%	26%	12%	6%	21%	20%	14%	38%	-7%	8%	0%						
Sales levels per franchisee	52%	39%	51%	63%	56%	49%	51%	43%	28%	50%	33%	30%	26%	53%	-21%	30%	42%	53%	41%	43%	13%	7%	36%	7%	15%	44%						
Operating costs per franchisee	-19%	3%	-6%	0%	-13%	0%	-15%	-21%	-39%	-39%	-42%	-70%	-56%	20%	26%	5%	-11%	0%	-29%	-21%	-27%	-50%	-57%	-50%	-25%							
Franchisee profitability levels	44%	21%	40%	49%	44%	40%	18%	7%	9%	-4%	3%	-4%	-12%	33%	47%	40%	21%	35%	0%	29%	-7%	-36%	-7%	-29%	-31%	19%						
Franchisor growth prospects	56%	45%	46%	57%	59%	48%	45%	28%	23%	39%	18%	7%	21%	47%	47%	50%	53%	47%	41%	43%	7%	0%	21%	7%	-17%	31%						

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

GENERAL BUSINESS CONDITIONS



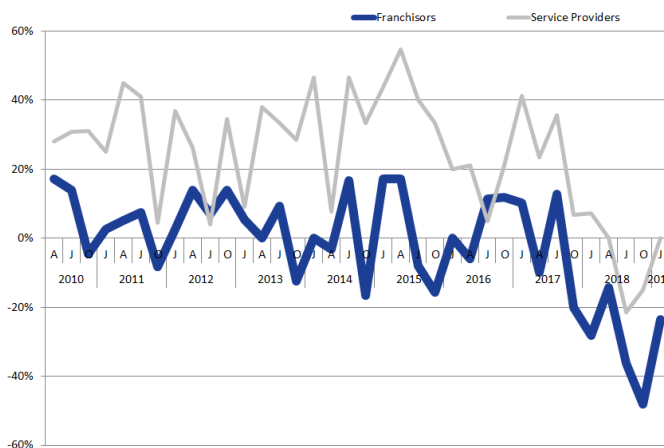
FRANCHISOR GROWTH PROSPECTS



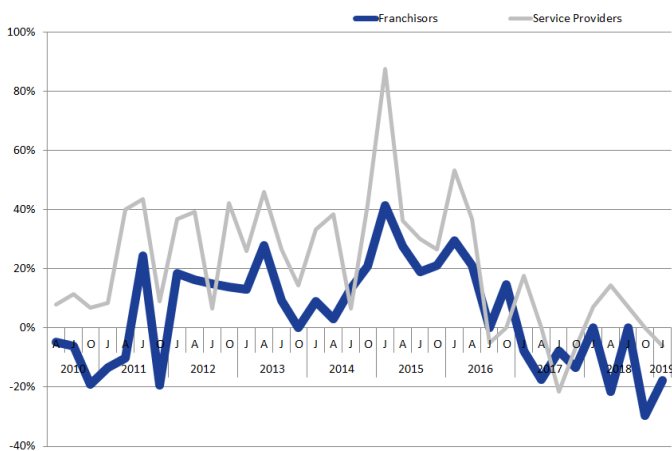
Franchisor sentiment for **franchisor growth prospects**, whilst still low showed strong improvement at net 23%, up from the previous quarter's net 7%. Service Providers net 19% improved even more up from net negative 27% in October.

Franchisor and Service Provider sentiment toward **access to suitable franchisees** has been seen as a key challenge for some time, however both indicated improved sentiment with Franchisors at net negative 24% (previously net negative 48%) and Service Providers at 0% (up from net negative 15%).

ACCESS TO SUITABLE FRANCHISEES

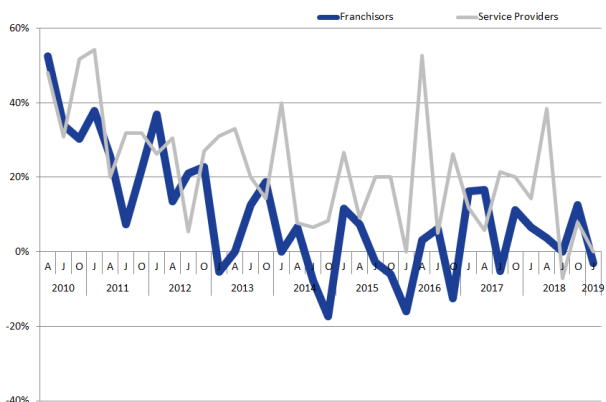


ACCESS TO FINANCING

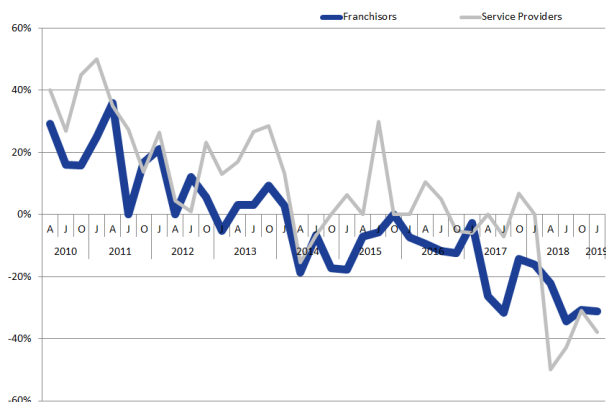


Franchisor sentiment toward **access to financing** rallied to net negative 18% up from an all time low of net negative 30% in October. Service Providers confidence was less positive dropping from 0% to a net negative 6%.

ACCESSTO SUITABLE LOCATIONS

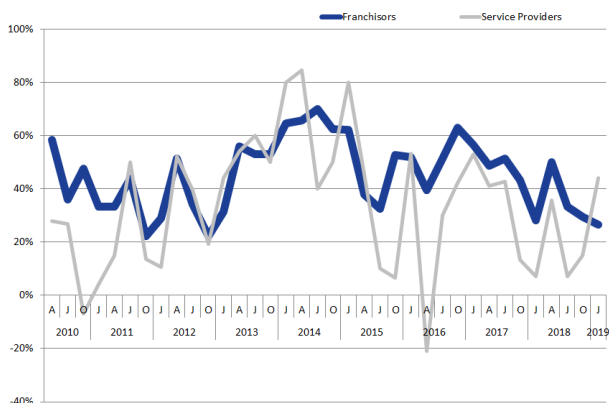


ACCESSTO SUITABLE STAFF

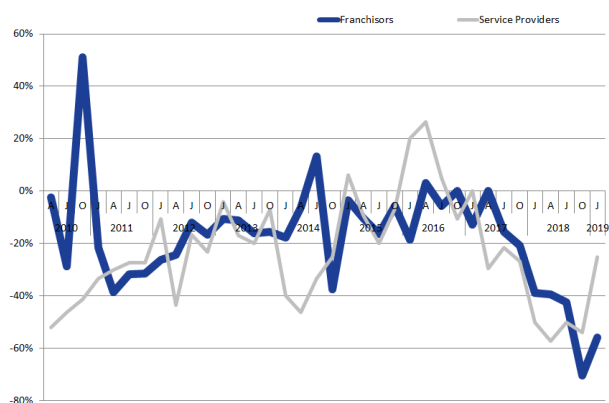


Franchisors, at net negative 3%, down from net 13%, were slightly more subdued this quarter in their outlook for **access to suitable locations**. Similarly, Franchisors indicated their outlook for **access to suitable staff** remains a key challenge with no change at net negative 31%. Service Provider confidence was similar with access to suitable locations, dropping to net 0% from net 8% and access to suitable staff at a net negative 38% (down from net negative 31%).

SALES LEVELS PER FRANCHISEE

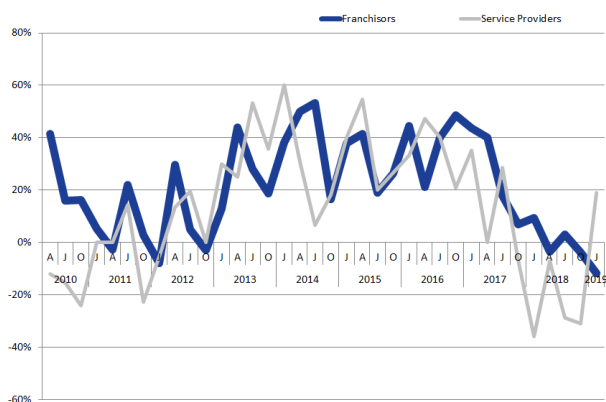


OPERATING COSTS PER FRANCHISEE



Franchisors sentiment toward future **sales levels per franchisee** dipped slightly to a positive net 26% (from net 30%), with Service Providers sentiment showing a strong increase at net 44% (up from net 15%). **Franchisee operating costs** have been seen as the greatest challenge for some time. Whilst still challenging there is improved sentiment from both, with Franchisors at net negative 56% up from net negative 70%, and Service Provider sentiment at net negative 25% up from net negative 56%

FRANCHISEE PROFITABILITY LEVELS



Franchisors, continue to report decreasing sentiment regarding **franchisee profitability levels** at a net negative 12%, down from net negative 4% and the lowest point to date. Service Providers were much more positive improving to a net 19% from a net negative 31%.

Franchising Outlook

Franchisors were asked for qualitative responses on how things were looking in their sector. Twenty-seven franchisors responded from a variety of self-reported industries such as retail, cleaning, financial services, hospitality, home services, insurance, education, construction and subtrades.

Comments were mixed between positive and negative – with most indicating some challenge ahead. On the positive were great demand, strong sales and steady growth. On the challenging side comments referred to immigration challenges, tightening demand, new competition, increasing operating costs (e.g., wages, rent, and other) and pricing pressure, slowing / reducing demand, legislative compliance, retail sentiment, projected house price declines / uncertainty, and, finding franchisees and staff.

The following examples were indicative of this sentiment:

- ↩️ *Commercial cleaning - Immigration changes may impact franchise sales.*
- ↩️ *Kitchen and cabinetry - perceive that overall business will be slower and access to new franchisees much worse as business is tightening. New competitors entering the business landscape (Ikea and Nido)*
- ↩️ *Liquor Retail - coming under increased cost pressure and margin squeeze. Highly competitive pricing*
- ↩️ *Our sector (pest Control) is going through a large legislative change. These changes have not been well communicated in the draft format and we are awaiting to see the final plan from the government departments involved in this change process*
- ↩️ *Retail - we are anticipating a slowing of the market in line with housing prices reducing*
- ↩️ *Roof restoration ...excellent availability of business but will struggle to tap it due to a lack of suitable labour.*
- ↩️ *We are growing in Australia and market recognition is growing along with work flow and profits*
- ↩️ *Commercial Cleaning - we have invested quite a lot of money to develop our staff and with this investment we see a much better growth*
- ↩️ *Commercial Cleaning: minimum wage increases and regional fuel tax have driven up costs which some customers unwilling to accept. Steady otherwise*
- ↩️ *Finance - consumer and small business. Increased vigilance required in credit assessment/management. Opportunities still good but will require good execution of franchisee sales capability and service levels.*
- ↩️ *Construction and things are quieter regarding numbers of prospects but busier in relation to conversions*
- ↩️ *Christmas/NY provided strong sales with general consumer spending appearing to be quite good still*
- ↩️ *Flooring and Window Furnishings - outlook is downbeat due to retail sentiment and house price outlook being negative in major metros*
- ↩️ *Steady growth (building sector)*
- ↩️ *Business advisory - expect marginal improvement in demand as economic conditions toughen*
- ↩️ *We have half the store up and half the store down so similar to last year*

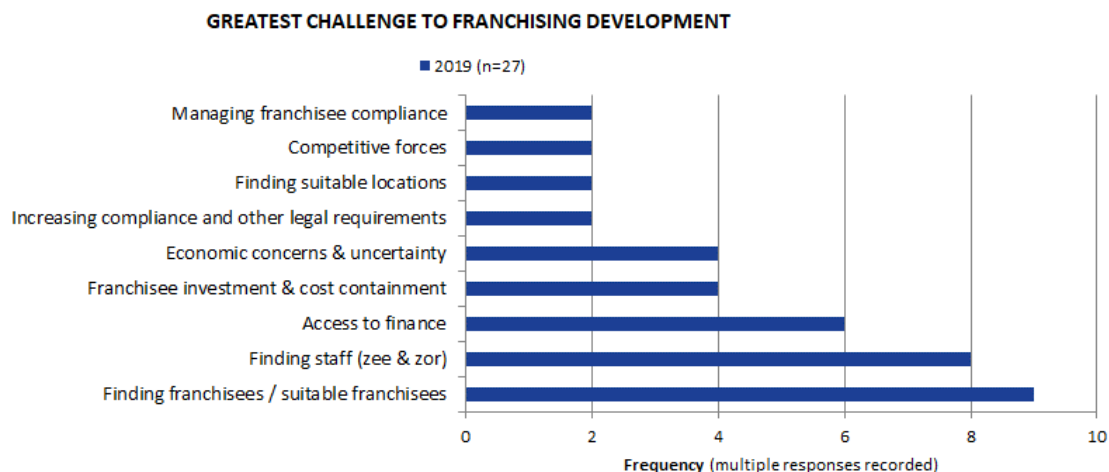
- ↵ Residential Construction - market is in decline in Auckland and Christchurch but regions still strong.
- ↵ Finding suitable franchisees continues to be the major issue
- ↵ Hard to find good staff who are not on a visa. Hospitality.
- ↵ Fitness & well-being. Greater competition
- ↵ Overall ok but access to finance from potential buyers is hurting
- ↵ Retail - Steady, concerned about increased wage and rent costs. Difficulty for Franchisees to attract suitable staff
- ↵ Home Maintenance - we anticipate a similar year to 2018. Franchisees who demonstrate a high level of customer service will continue to do well.
- ↵ Stable, residential renovations
- ↵ Hospitality – Cafes. Sector will be ok revenue wise but huge challenge due to increased minimum wage and other costs
- ↵ Buying and selling second hand goods plus unsecured lending
- ↵ Not a lot of change from last year

Service Providers were similarly asked how they thought things were looking for franchisors and franchisees. Their responses also provided a mixed future outlook. Key examples include:

- ↵ Although the usual challenges remain, there will still be room for growth for those franchisors who provide stand-out leadership and services to their franchisees.
- ↵ Facing a few headwinds in the near future
- ↵ Difficult to say at the moment, the economy seems to be holding its breath.
- ↵ Legal - continue to be tight but looks good for us.
- ↵ Professional services acting for a wide variety of franchise clients, most of who are not that positive about the year ahead.
- ↵ Sales performance are pretty solid, albeit not growing much
- ↵ Still some opportunity particularly in the regions. Ability to find suitable sites and franchisees may tighten up.
- ↵ Reasonably optimistic. A lot of the gloomy predictions about Trump and trade have failed to materialise, although there will be some uncertainties - as always.
- ↵ Very positive indeed
- ↵ Period of consolidation rather than much change, for better or worse.
- ↵ More of the same

Greatest Challenge to Franchising Development in 2019

For the eighth year running franchisors were asked what they perceived to be the greatest challenge to franchising development in the year ahead. The following chart plots the frequency of key comment themes.



As demonstrated, 9 of the 27 responding franchisors identified finding the right / suitable / great franchisees as the top challenge to their development. This continues to be the foremost challenge identified by franchisors. Immigration rules were cited as a contributing factor by a minority in this area, as was the strength of the economy – encompassing ‘full employment’ and a resultant reduced likelihood someone would leave well-paid employment to buy a franchise.

The next greatest identified theme was finding the right / skilled staff to fit the business, with eight responses. Finding staff was predominantly mentioned from a franchisee growth standpoint - but also support office staff, in one instance. ‘Immigration rules,’ ‘full employment’ and the ‘availability of labour’ were cited as contributing factors.

Franchisors also cited issues associated with access to finance – an area that focuses on capital as a constraint for new franchisee creation or potential resale.

Franchisee expense inflation and economic concerns gained equal mentions, with four related responses. All mentioned franchisee expense areas referred to increases in wages, with the following notable example:

🔊 *The tightening of working Visa conditions and the significant increase in minimum wage are going to create substantial pressure this year.*

Economic concerns and uncertainty responses variously referred to full employment (as a constraint for franchisee growth and staff recruitment), immigration cuts (making franchisees more difficult to find), global financial uncertainty (impacting confidence) and market outlook. As one respondent noted regarding employment levels:

🔊 *The very high levels of employment are we believe impacting the number of people looking to buy a small business. The ability to earn a solid salary vs place savings at risk is having a toll at present*

Other identified challenges, with more than one citation, included managing franchisee compliance, increasing competition, finding suitable locations and increasing legal compliance costs.

Previous Year Comparisons

Finding franchisees / suitable franchisees continues to be the dominant identified challenge to franchising development, as it has for the preceding seven years. Finding suitable staff enter as the second top theme, for the second time – after not featuring in the top five last year. Similarly, access to finance was third this year, after not featuring as a top challenge since 2016. And finally, franchisee operating costs and economic concerns continued, similar to last year, as issues around franchisee investment and operating costs, and economic concerns continue to feature as they have in 2016, 2017 and 2018.

TOP CHALLENGE RANKINGS

	2012	2013	2014	2015	2016	2017	2018	2019
<i>Finding Franchisees</i>	1	1	1	1	1	1	1	1
<i>Access to Finance</i>	2	5			4			3
<i>Economic Concerns</i>	3	3	2		5	4	4=	4=
<i>Investor Confidence</i>	4							
<i>Finding Suitable Locations</i>	5		5	5	2			
<i>Franchisee Business Model Challenges</i>		2				5	4=	
<i>Online Retail Threat</i>		4						
<i>Franchisee Business Execution</i>			3					
<i>Finding Suitable Staff</i>			4	2		3		2
<i>Franchisee Investment / Operating Costs</i>				3	3	2	3	4=
<i>Competition</i>				4				
<i>Increasing compliance & legal requirements / uncertainty</i>							2	

While still noted as a concern to some, it is interesting to see increasing compliance requirements or legal uncertainty move out of the top five this year.

What Will Provide the Greatest Opportunity Related to Franchising Development in 2019?

This year we once again asked Franchisors and Service Providers what they perceived to be the greatest opportunity related to franchising development in the year ahead. A wide variety of internal and external factors were cited. Key themes identified by Franchisors and Service Providers included use of technology, better selling to established customers, growth through existing franchisees, continued strong demand (in certain sectors), potential improvements to labour, franchisee and site availability, franchise business optimisation, commercial developments (e.g., Newmarket 277) with new locations, brand / marketing investment, focus on processes and systems, new products, and, potential recession (leading to improved franchisee recruitment and labour availability).

Concluding Comment

Franchise Consultants' Franchising Confidence Index in January 2019 demonstrated a hint of optimism – albeit many sentiment measures still remained net negative. General business conditions, access to suitable franchisees, operating costs per franchisee and franchisor growth prospects, whilst still showing negative sentiment, all indicated some improvement compared with the previous quarter. Meanwhile, declines were noted for access to suitable staff and availability of suitable locations.

Franchisor outlook commentary was mixed, with positives for some regarding obvious strength in demand, sales and sales growth. Those more challenged, however, referred to a number of issues such as immigration challenges, tightening demand, new competition, margin compression, legislative compliance, retail sentiment, projected house price declines, and, difficulties finding franchisees and staff.

Separately, and more specifically, franchisors identified their greatest challenge to franchising development (in the year ahead) as finding suitable franchisees, finding suitable staff, access to finance, franchisee cost containment, and uncertainty regarding the economy. Challenges finding suitable franchisees has been the top-rated challenge in each of the past seven surveys.

On the positive side, franchisors provided a rich set of opportunities relating to franchise development in the year ahead, with examples including technology, better selling and more marketing, growth through existing franchisees, potential improvements to labour, franchisee and site availability (largely driven by a potential slow down, a focus on efficiency improvements, and new products).

Franchising is not alone in lacking strong confidence toward future business conditions, as earlier comparisons to key New Zealand general business surveys have indicated. Key will be ensuring that this backdrop of somewhat dour sentiment does not dampen positive steps, innovation and investments directed toward continually improving franchise system performance and associated franchisor and franchisee returns.

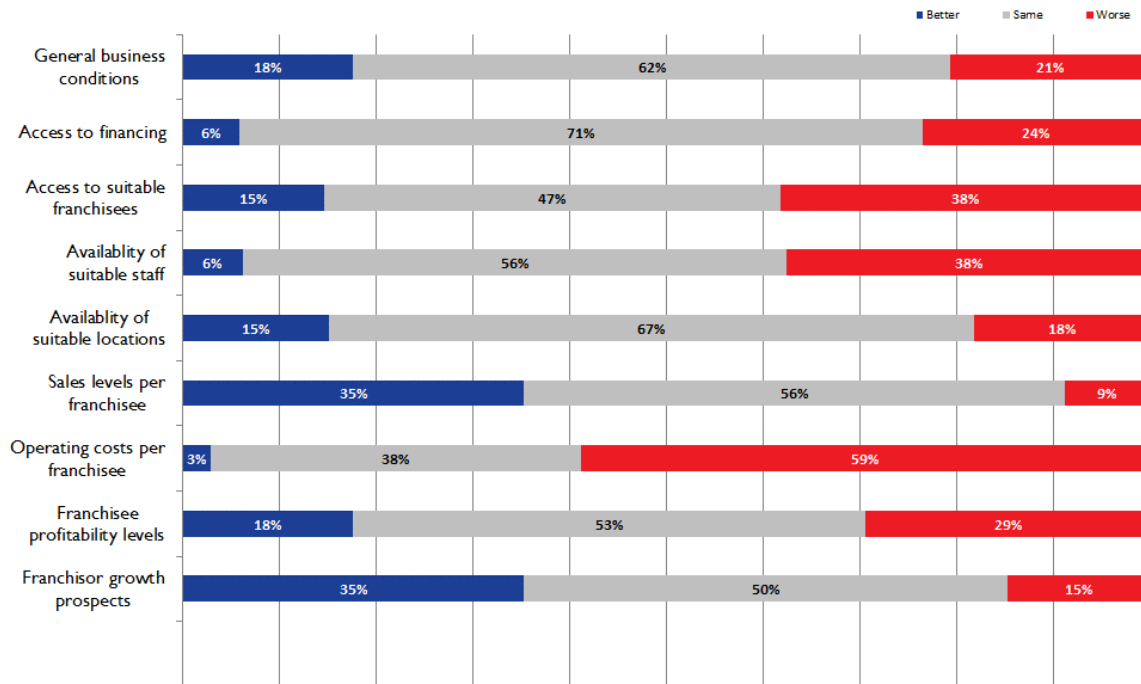
We at Franchise Consultants note the general resilience of franchising systems; however, it remains our view that much can be done to better future-proof franchise networks and build more valuable and sustainable businesses for franchisors and franchisees alike. We maintain that vigilance in identifying and acting on making improvements and change, where required, is imperative to ensure the sustainability of your franchise system.

Franchise Consultants notes, within such steps, the criticality of understanding gaps and opportunities relating to franchise system structure and management – from a franchisor and franchisee perspective. Franchising companies established for more than five years should consider a comprehensive Franchise Review, as part of their overall planning and improvement initiatives.

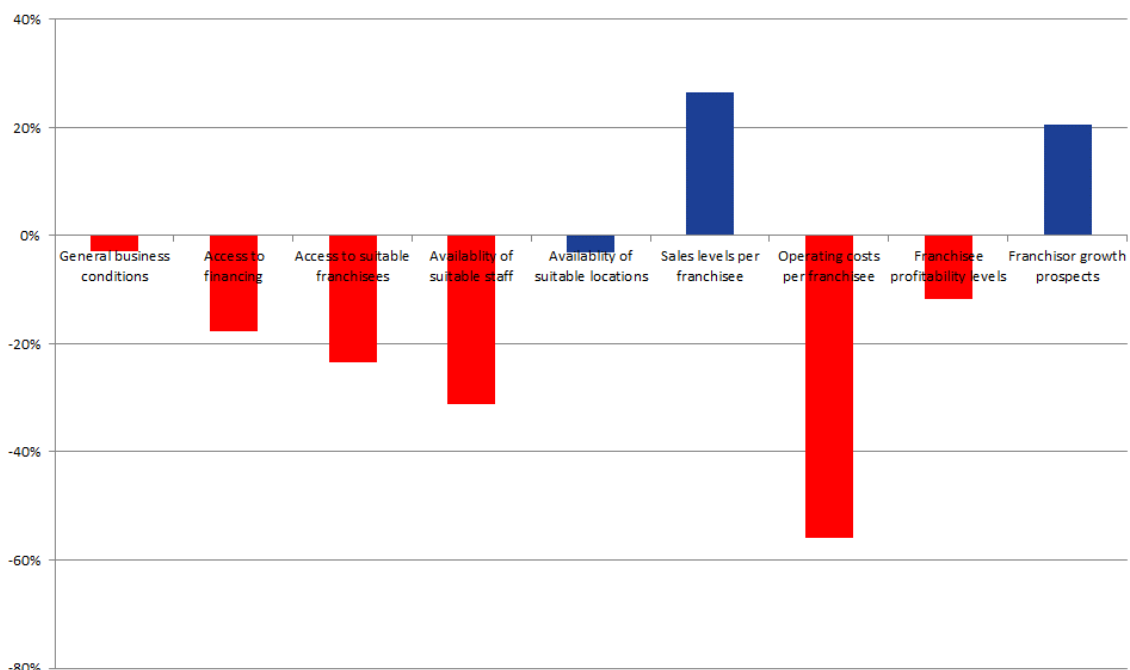
FRANCHISING CONFIDENCE CHARTS

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).

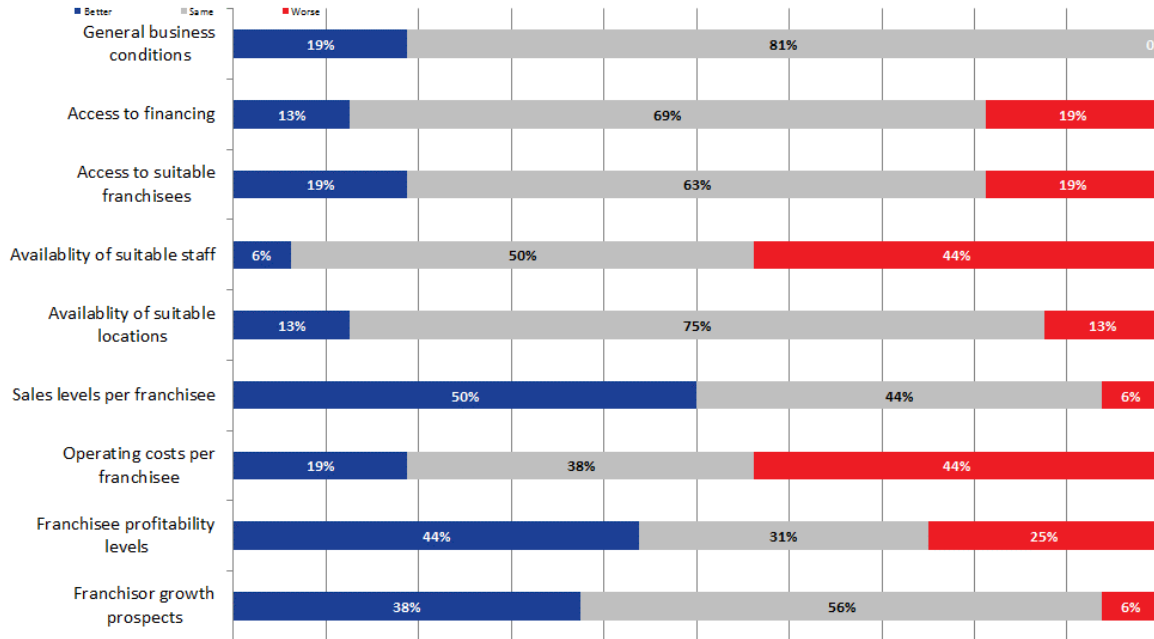
FRANCHISOR EXPECTATIONS (next 12 months)



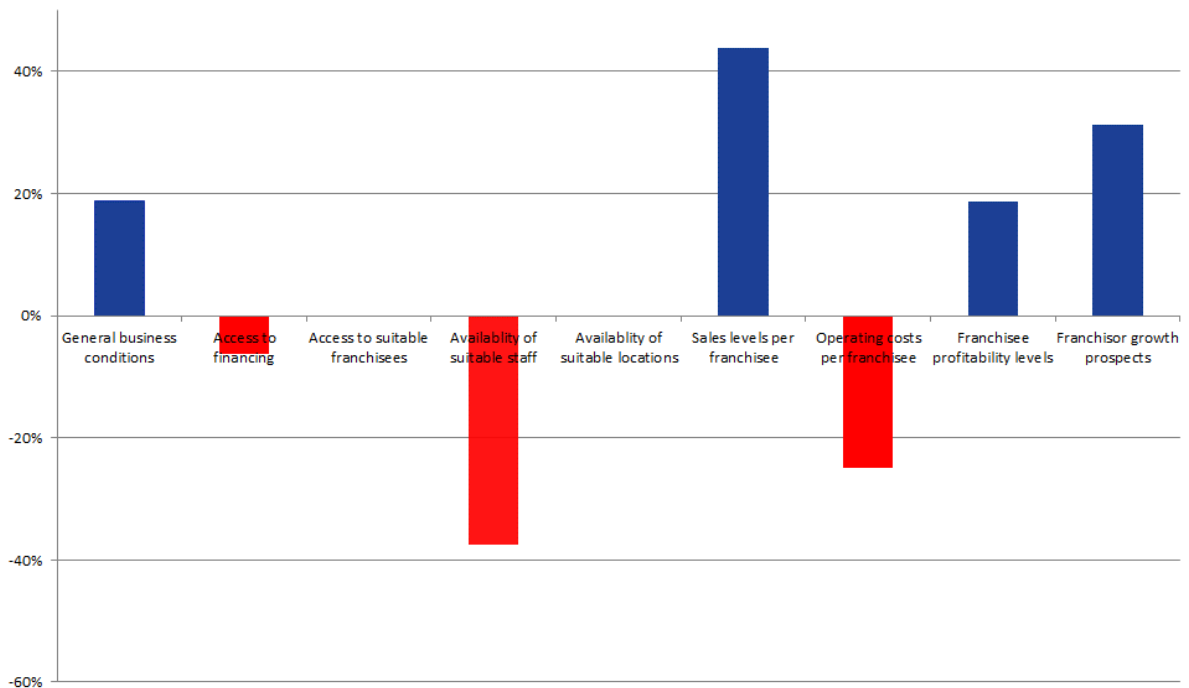
NET FRANCHISOR EXPECTATIONS



SERVICE PROVIDER EXPECTATIONS (next 12 months)



NET SERVICE PROVIDER EXPECTATIONS



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 recent *Franchising New Zealand 2017* survey, conducted by Massey University in collaboration with Griffith Business School, indicates New Zealand has 631 individual franchise systems comprising some 37,000 units (owned mostly by franchisees). The survey also suggests local franchise systems employ some 124,200 people. Finally, local expert estimates of total franchise system turnover is \$27.6 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 34 franchisors and 16 Service Providers collected between Monday 14th January and Friday 25th January 2019. 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 Kayleen Smith.

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Franchising Confidence Index

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