FRANCHISE CONSULTANTS

FRANCHISING CONFIDENCE INDEX

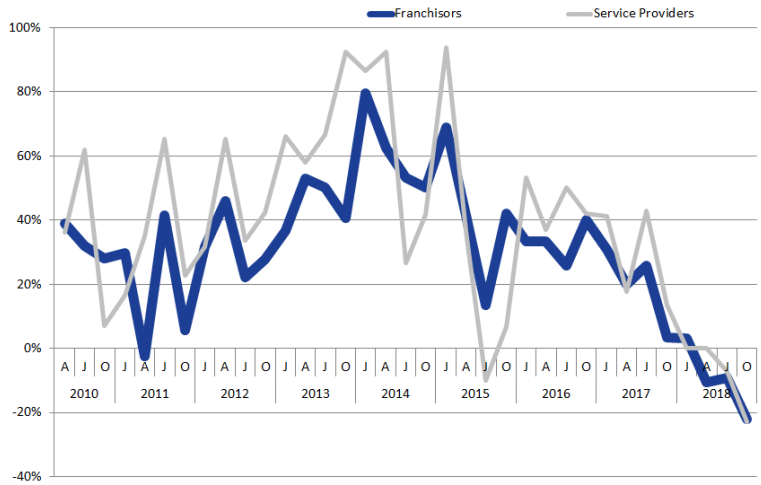
Release Date: **Friday 26 October 2018**

Franchising Business Sentiment Challenging

Franchize Consultants' October 2018 *Franchising Confidence Index* continues to suggest challenges as perceived by responding franchisors. Responding franchisor sentiment towards operating costs and operating costs per franchisee were most negative and moved most (compared to the previous quarter). Franchisor outlook, for availability of suitable staff (whilst still in negative numbers), and suitable locations showed slight improvements. Of note, sentiment towards sales levels per franchisee was relatively stable and positive on balance.

Franchisors' sentiment towards **general business conditions** dropped, after lifting very slightly last quarter, from net negative 9% to net negative 22%. Service Providers sentiment showed a mirror effect dipping to net negative 23% from a net negative 7%.

GENERAL BUSINESS CONDITIONS



Franchisor views on general business conditions still remained more positive than that of other research involving general business confidence. The ANZ Business survey which has shown some fluctuations month on month is currently at net negative 38% in comparison to a net negative 39% in June. Similarly, the NZIER business survey, released in early October, recorded a net negative 28% - compared to a net negative 19% in July.

Our experience, now involving some 35 consecutive quarters (over eight calendar years), indicates that franchisors are normally more positive toward future general business conditions compared to datasets involving other organisational forms.

RESULTS SUMMARY TABLE

	Franchisors												Service Providers											
	2016				2017				2018				2016				2017				2018			
	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%	53%	37%	50%	42%	41%	18%	43%	13%	0%	0%	-7%	-23%
Access to financing	30%	21%	0%	15%	-8%	-18%	-8%	-13%	0%	-21%	0%	-30%	53%	37%	-5%	0%	18%	0%	-21%	-7%	7%	14%	7%	0%
Access to suitable franchisees	0%	-6%	11%	12%	10%	-10%	13%	-20%	-28%	-14%	-36%	-48%	20%	21%	5%	21%	41%	24%	36%	7%	7%	0%	-21%	-15%
Availability of suitable staff	-7%	-9%	-12%	-13%	-3%	-26%	-32%	-14%	-16%	-22%	-34%	-31%	0%	11%	5%	-5%	-6%	0%	-7%	7%	0%	-50%	-43%	-31%
Availability of suitable locations	-16%	3%	6%	-13%	16%	17%	-5%	11%	7%	4%	0%	13%	0%	53%	5%	26%	12%	6%	21%	20%	14%	38%	-7%	8%
Sales levels per franchisee	52%	39%	51%	63%	56%	49%	51%	43%	28%	50%	33%	30%	53%	-21%	30%	42%	53%	41%	43%	13%	7%	36%	7%	15%
Operating costs per franchisee	-19%	3%	-6%	0%	-13%	0%	-15%	-21%	-39%	-39%	-42%	-70%	20%	26%	5%	-11%	0%	-29%	-21%	-27%	-50%	-57%	-50%	-54%
Franchisee profitability levels	44%	21%	40%	49%	44%	40%	18%	7%	9%	-4%	3%	-4%	33%	47%	40%	21%	35%	0%	29%	-7%	-36%	-7%	-29%	-31%
Franchisor growth prospects	56%	45%	46%	57%	59%	48%	45%	28%	23%	39%	18%	7%	47%	47%	50%	53%	47%	41%	43%	7%	0%	21%	7%	-17%

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

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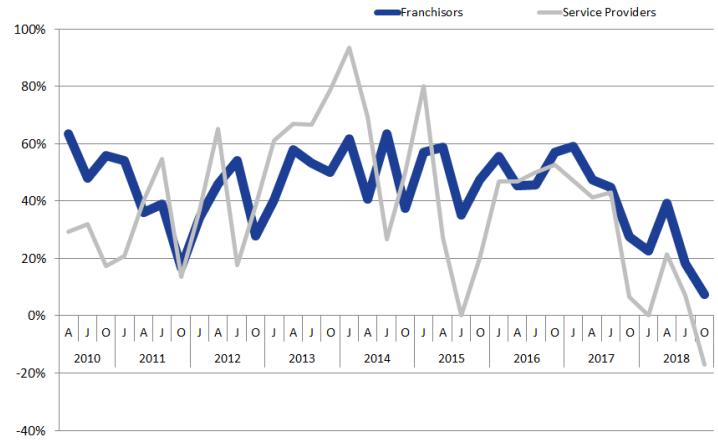
FRANCHISOR GROWTH PROSPECTS

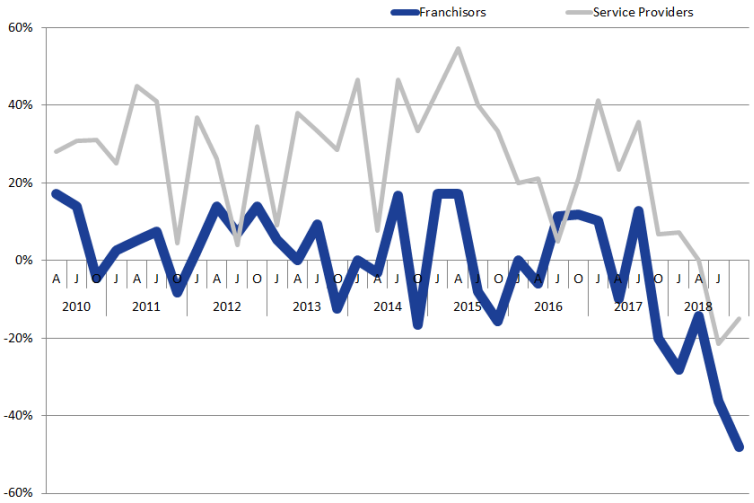


Franchisor sentiment toward **franchisor growth prospects** remained in positive numbers at a net 7% - albeit reduced from the net 18%, in July.

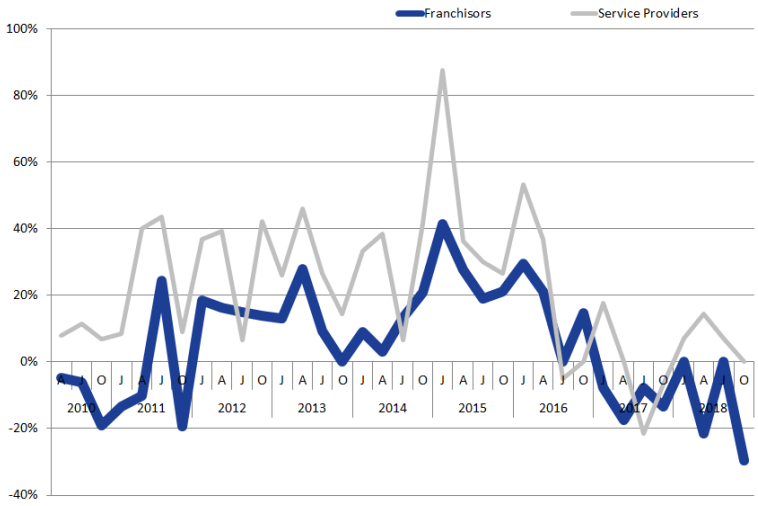
Service Providers sentiment followed a similar trend, dropping from net 7% previously to a net negative 17% this survey.

ACCESS TO SUITABLE FRANCHISEES

Franchisor sentiment toward **access to suitable franchisees** remained challenging - at a net negative 48% down from net negative 36%. Service Providers sentiment indicated a softening in this area improving to a net negative 15% from net negative 21%.



ACCESS TO FINANCING



Franchisor sentiment toward **access to financing** is continuing to fluctuate quarter to quarter dipping to net negative 30% from a net 0% previously. Service Provider sentiment had previously remained in the positives but dipped to a net 0%.

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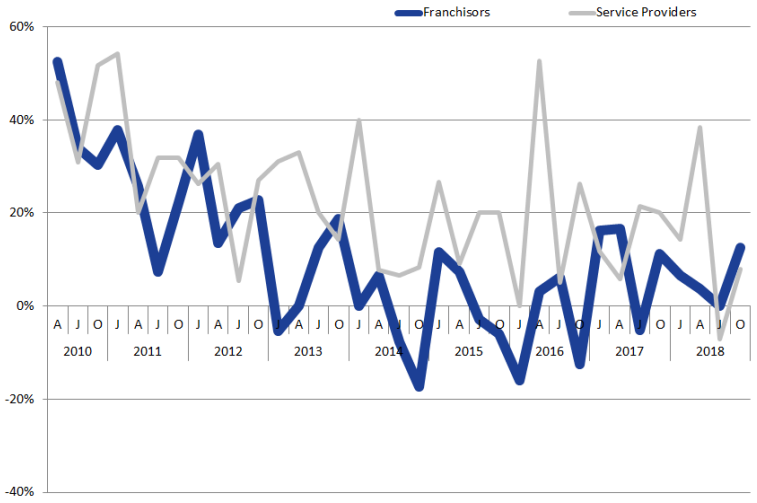
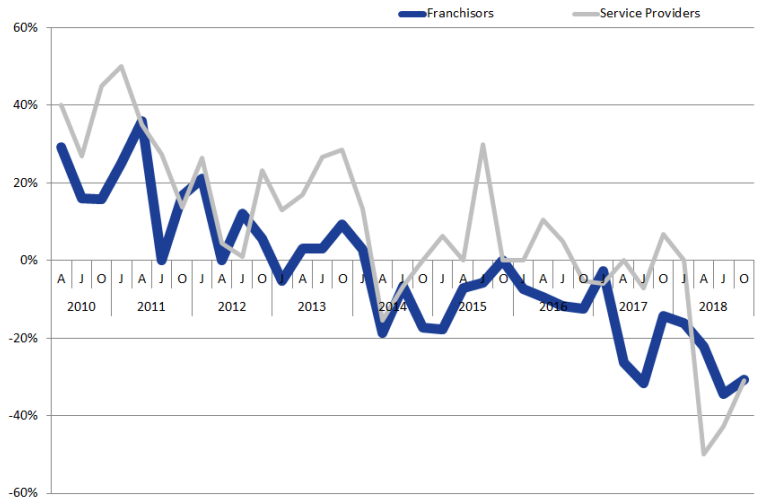
This quarter's Franchisors and Service Provider sentiment towards **accessing suitable locations,** saw a decided improvement at a net 13%, up from net 0% for Franchisors. Service Providers' sentiment was similar at a net 8% up from net negative 7%

ACCESS TO SUITABLE LOCATIONS



Franchisors and Service Provider sentiment toward the **availability of suitable staff** saw some buoyancy despite comments of continued concern. Franchisors improved from a net negative 34% to a net negative 31%, whilst Service Providers improved more positively from a net negative 43% to net negative 31% this quarter.

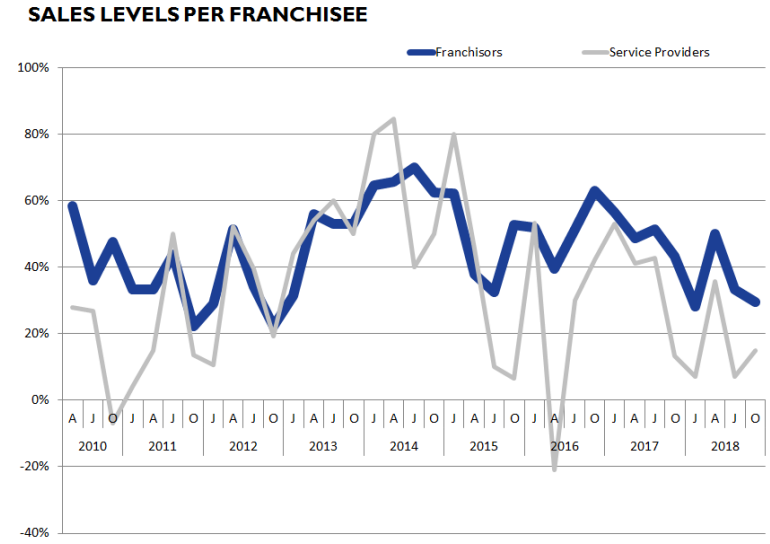
ACCESS TO SUITABLE STAFF



The Franchisee Picture

Franchisor and Service Provider sentiment towards **franchisee sales levels**, whilst fluctuating, has remained the most consistently positive area over the past 12 months. Overall sentiment remains positive, despite Franchisor expectations declining very slightly from net 33% to net 30%, and Services Providers improving from net 7% to net 15%.

SALES LEVELS PER FRANCHISEE



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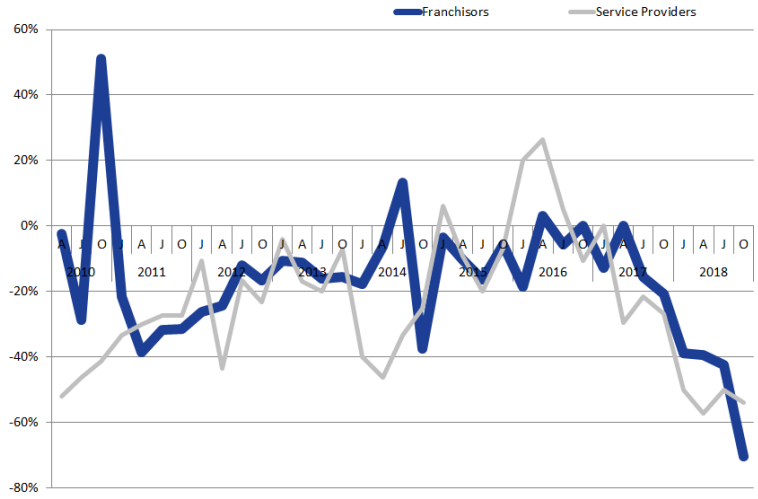
OPERATING COSTS PER FRANCHISEE

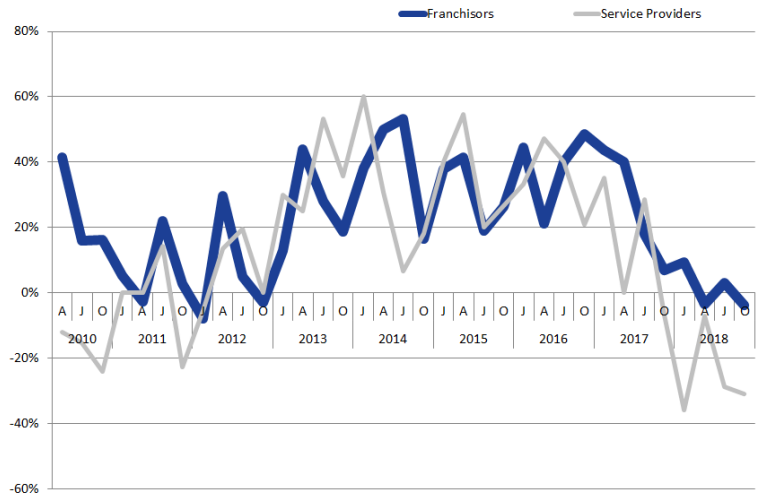


Whilst franchisee sales perceptions are stable that sentiment is not extended to **Franchisee Operating Costs.** That area continues to create concern, currently at a net negative 70% down from net negative 42%. Clearly there is huge concern. Service Providers show equal concern in sentiment at net negative 54% down slightly from July's net negative 50%.

Finally, Franchisors' sentiment towards **Franchisee profitability levels**, which are a strong indicator of the economic climate, have remained relatively stable over the past five quarters, at a net negative 4% after a previous increase to net 3%.

Service Providers sentiment remains stable although at a lower level of net negative 31%, down from net negative 29%.

FRANCHISEE PROFITABILITY LEVELS



Franchising Outlook

In addition to the framed topics, **Franchisors** were asked for qualitative responses on how things were looking in their particular business sector. Eighteen useable responses were received:

- *Our sector of business is going through a number of large legislative changes which could see a number of experienced technicians leave the industry. This has both positive and negative effects on the industry and our own business. These changes have the potential to cause some disruptions over the next 12 - 24 months*
- *Commercial Cleaning - very hard as there is so much competition out there. we are evolving all the time to stay current in the market and this is very costly to a very small profit organization.*
- *Sports retail - appears to still be growing as a sector*
- *Good, sales are still growing. beverages*
- *In the automotive market customers are delaying servicing and repairs and holding onto cars longer. Coupled with a decreasing number of 6 month WoFs in the market means the automotive industry is challenging*
- *Overall business growth tapering comparatively to 2017. Difficult finding suitable staff. Recurring business slower.*
- *Finance Wellington. Much harder, more competition*
- *A positive change to regulations in our industry (namely CCCFA) will allow Franchisees to operate without a cloud hanging over their heads. It will likely trim margins but we are optimistic it will improve the industry perception*
- *Service sector, not good, bank lending is tightening up and franchisees are hard to come by*
- *Home services More demand, but squeeze on pricing*
- *Hospitality- massive struggle with staff, particularly chefs. Very much a buyers market for cafes and other hospitality outlets currently with buyers being very cautious and in the Café market preferring existing businesses to new opportunities*
- *Retail. There is a feeling that we are holding onto last years same store turnover for past 6 months. Last year saw a drop so nice to see a little business confidence back around the country.*
- *Home Services. Good franchisees very hard to find.*
- *Our area is takeaway coffee stores. We have around 18 stores across North Island. It will be tough times in the next few years as minimum wage going up and a slowdown on immigration will take its toll. We will probably see a big shortage of the staff who will not want to work in retail.*
- *New immigration/visa rules are making it very tough in the Food & Beverage sector to recruit good quality team members. Increases in fuel/delivery costs are also starting to be passed on suppliers, pinching margins and no doubt leading to price increases.*
- *Retail - Good franchisees and rentals remain significant barriers to growth*

- *Business owner advisory area. Believe demand for our services will increase as economic conditions deteriorate.*
- *Retail Sector - Difficult to employ quality team members and expecting hourly rates to substantially increase.*

Franchise Service Providers were similarly asked how they thought things were looking for franchisors and franchisees. Their responses showed a mix in sentiment with equally positive and negative thoughts.

- *General business sentiment seems to be that the economy as a whole is slowing, which may mean tougher business conditions and/or a wait and see mentality*
- *The economy is going okay, finance is cheap. Margin compression, difficulties in finding and keeping staff, and a range of other issues are affecting many franchise systems.*
- *Challenging. Increasing costs (fuel related, compliance, longer term interest rates, increasing minimum wage etc) will all impact negatively. Immigration, whilst slowing, is still expected to be positive and this should assist with demand*
- *The constant talking down of business confidence is doing no-one any favours. Yes, there are uncertainties at the global level (when are there not?) but are actual results reflecting this? Many franchisors and franchisees seem to be very busy, with shortage of staff the biggest issue.*
- *Very good indeed*
- *Perceptions of a slowing economy and higher transport costs will start to become a reality post Christmas.*
- *the hike in petrol prices is bound to effect profitability for franchisees with a flow on effect for franchisors*
- *Business confidence remains uncertain. A good time to get updates and system improvements addressed.*

Concluding Comments

Franchize Consultants' October 2018 Franchising Confidence Index indicates growing future uncertainty and challenge.

Most notably responding franchisors indicated current and future challenges concerning finding and retaining quality staff, franchisees and accessing funding – all key growth constraints. Comments also included concerns around the impact legislative changes (although this included some positive sentiment), immigration changes and minimum wage changes on their businesses. Comments also touched on the intensity of competition, tightening demand and tightening margins.

However, while sentiment towards general business conditions has taken a slightly larger hit this quarter, there are indications in comments that some industries are seeing growth. Finally, franchisor sentiment toward their own growth prospects, whilst lower, remained positive on balance.

Overall, we believe that whether the challenges are more perceived than real (or not), franchisor and franchisee businesses would be diligent to prepare for a tougher business environment. That means ensuring franchise system foundations, processes and management are sound – at a franchisor and franchisee level. Typically, we note both sides have a multitude of improvement opportunities. We caution that now is a time to understand both shortcomings and opportunities, and to prioritise those areas together that can enable growth and sustainability.

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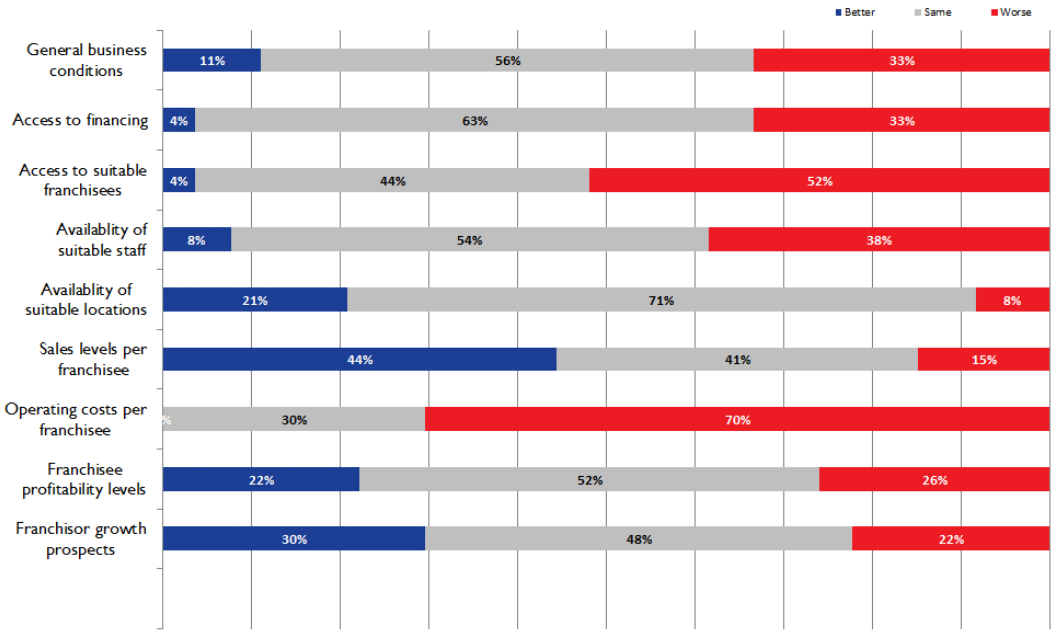
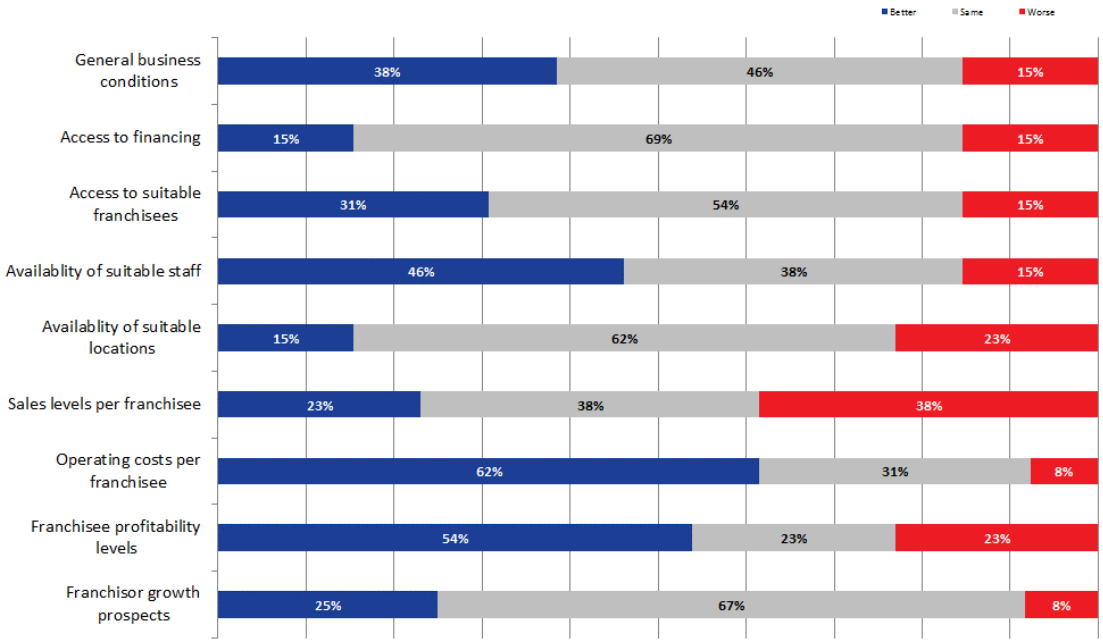
FRANCHISING CONFIDENCE CHARTS

The following four illustrations summarise 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)

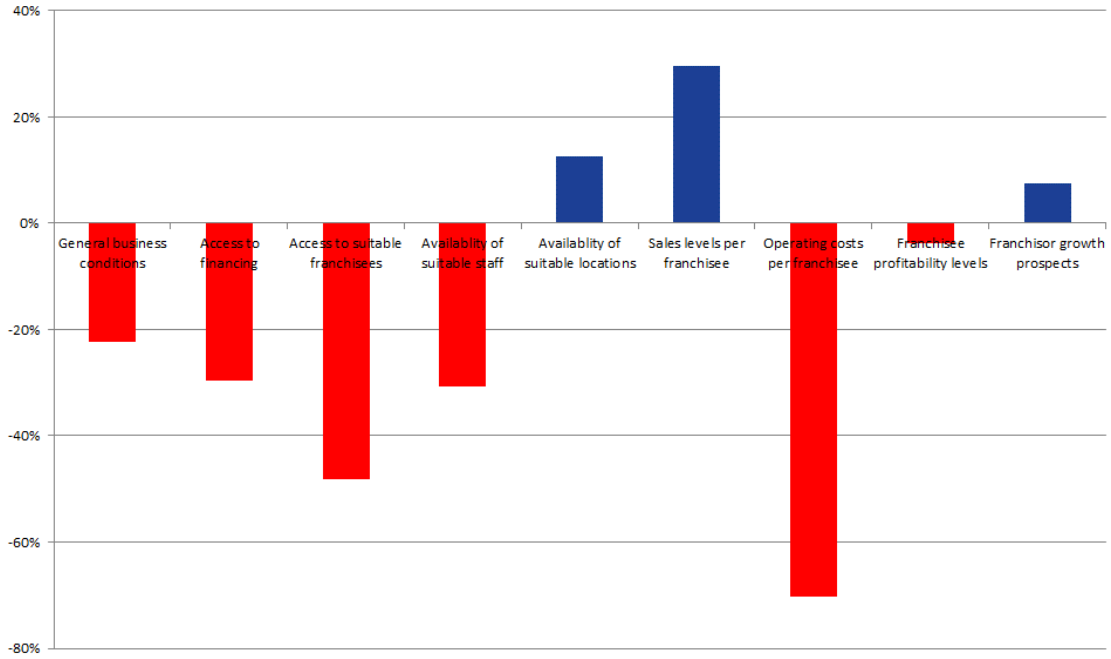
FRANCHISOR EXPECTATIONS (next 12 months)



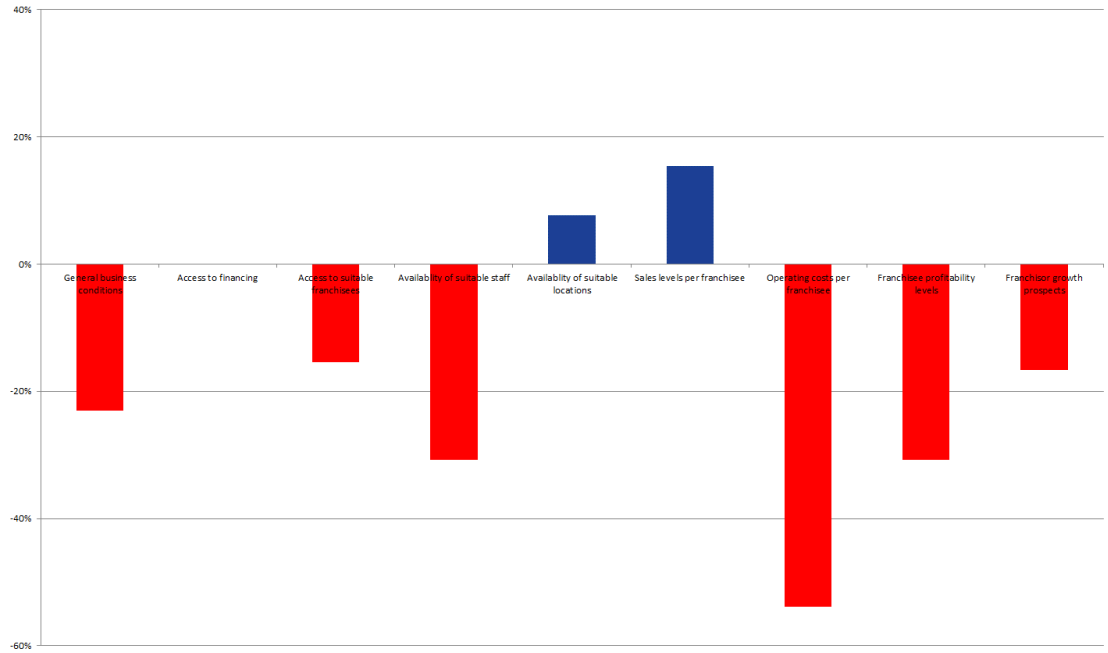
SERVICE PROVIDER EXPECTATIONS (next 12 months)



NET FRANCHISOR EXPECTATIONS



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 *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 range from $27 to $46 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 27 Franchisors and 13 Service Providers collected between Monday 15 October and Friday 19 October 2018. 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, Franchize Consultants.

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Franchize Consultants are New Zealand's premier franchise consulting specialists, now operating in their 30 year.

Thinking of franchising a business? Franchize Consultants help evaluate and establish franchising and licensing networks.

Thinking of improving the results of an established franchise network? Franchize Consultants have had great success improving established franchising and licensing network performance for all stakeholders.