THE OUTLOOK FOR FRANCHISING

Michael Sherlock, ex CEO of Brumby's Bakeries, Consultant and Mentor to franchisors and co-author business growth strategy book Jumpshift! - a manual to put your business into Hyperdrive! gives his outlook on franchising in Australia in 2013.

WHICH AREAS OF FRANCHISING DO YOU PREDICT ARE ON THE UP FOR 2013?

There are six sectors that are well positioned for growth:

- **Education** - I have noticed the amount and difficulty of my two youngest children's home work. So tutoring, after school care, vacation care, music and other coaching will be in demand.
- **Aged Care** – In-home care, with the ageing population and longer life expectancy, there will be insufficient low care beds, and the government is actively encouraging home based care.
- **Rental of household and commercial items** – recently I was talking to the CEO of one of the largest furniture retail groups, who advised that sales are tough as lenders have really tightened up on lending. Even lending via in-store finance arrangements is difficult as very few customers now qualify. At the same time Radio Rentals, Mr Rental, Silverchef etc are doing well.
- **The Mining Sector** – The number of projects in the pipeline is still very strong and it will last for decades. There are many openings for franchised goods and services to be supplied to these new "Gold Rush" towns. Labour is at a premium in these areas so any franchised system that can deliver 'ready to go' accommodation, food, entertainment and quality of life products are likely to experience growth.

- **IT** – The IT industry has so many new resources and ways of doing business that the online sales threat to bricks and mortar retailing will continue to take market share. We will see the benefits of the new IT age. I am aware of an App about to be launched that will eliminate paper and plastic loyalty cards, enable customer communication and rewards marketing via Smart Phones and there are no high set up costs as it uses QR codes.
- **Low labour systems** – The 24/7 gym sector has continued to expand, other systems with a similar low labour model where someone re-focuses on a tired sector and gives the customer what they want should perform well, for example new-age coinless Laundromats are booming in Brazil .

CONVERSELY, WHICH AREAS DO YOU THINK MIGHT STRUGGLE DURING 2013?

I've identified several sectors that will continue to struggle and new areas that will be challenged:

- **Old technology** - Video stores are disappearing. Many of their sites are converting to 24/7 gyms. The secret is to adapt. Look at JB Hi-Fi who were originally in the photo processing business. They still sell cameras but have moved ahead of the technological changes to reflect consumers' future needs. That is the challenge for the video industry.
- **Mature QSR brands who don't adapt** - Look at what has happened to the pizza sector. The market was price driven at the expense of quality. Now new brands offering gourmet pizza menus are booming – eg Crust, Capers. The same has happened to the Mexican, chicken and hamburger segments. There is also growth in the same mature markets, the new Subway type product Pitta Pit is an example of a new twist on a proven formula. Daryl Lee is a classic example of what happens if you do not keep up.
- **High rent and high labour based systems** - With rents climbing the skill shortage, labour costs and competition from the mining boom, mature brands particularly those in food that rely on skilled labour will come under increasing pressure.

HOW HAS FRANCHISING FARED IN 2012?

As usual different sectors have had different results. It's a matter of adapt or perish to keep up with consumers' needs. A great example is the old gym model compared to the new 24/7 model. The 24/7 gyms are the best franchised system I have seen in my time, characterised by consumer focus, no stock, one wage, half the membership cost, no locked-in contracts, always open, state of the art equipment that is IT connected so members have lots of interesting distractions while exercising. Most gym clubs only need 900 members and there is no cash - all direct deposit.

The challenge is when will saturation point be reached?

It is also one of the few sectors where the franchisee does not need to be hands-on. They still need the 'owners eye' to run the system (they are all externally monitored on Smart Phones) but do not have to spend 10 hours a day, seven days a week behind the counter.

HOW IS FRANCHISING AS A WHOLE SECTOR TRAVELLING?

It is still the best system to get a product or service to market. I see the essence of franchising as the 'owners eye'. The franchisee is far more motivated and rewarded than any employee on a profit share will ever be. The difference is when the going gets tough the last thing to be paid is the owner's wage, so they roll up their sleeves, follow the system and brand provided and make it work. I am yet to meet an employee who will cut their wage when losses are incurred.

The sector faces many challenges, franchisee recruitment, tough retail environment, skill shortage, rising costs of doing business and occupancy costs. Franchising however, is still the best model for labour and capital using all the benefits of a brand and system provided.

WHAT ARE THE BIGGEST CHALLENGES TO THE SECTOR FOR 2013?

A healthy sector needs to be one of balance. A franchisee should be able to work hard, follow the system and get a reward for their effort, dedication and risk including wages, annual profit and capital gain. The franchisor should be able

to support their system, expect compliance and make an annual profit and capital growth.

I see many systems where the franchisor is taking too much profit from the system while not supporting the franchisees with marketing, new products, mentoring, training and keeping the system ahead of their competitors and customer focused. The areas that need balancing include:

- Rebates - I have seen many mature systems where the franchisee is not getting the purchasing power benefits - they can do better on their own.
- Marketing Funds - Some franchisors take too much out of the levy and leave little for attracting new customers. One system I observed spent less than 10 per cent on actual external marketing activity.
- Renewals and additional fees levied.
- Buy back of stores at written down value when the deed has expired.
- Sale of company owned stores well below the cost of a new store or worth of an existing store.
- Image updates, internal costs levied to approve.
- Compulsory purchase of equipment and annual support costs that are above what is available elsewhere.

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