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FORECASTING SALES HOW MUCH WILL YOU SELL?

The biggest question asked when selecting and opening a new store or business is ‘how much or how many will we sell?’.

For many franchisees, you are opening your first business (often in retail), and you are risking all your hard work, house, life savings, right up to the kid’s toys to afford the money to begin your new venture. You will have done a business plan, normally with your franchisor, and you think all looks positive.

The question I pose to you is how do you realistically estimate the sales your new business will do?

The franchisor may offer to provide some information such as the demographics of the area, and maybe a listing of phone numbers of other franchisees for you to talk to, but the final word from the franchisor is often along the lines of “do your own due diligence, as I cannot say what sales revenues you will generate”.

In many cases this is the truth AND following some legal cases over the last few years, most franchisors are not prepared to give any concrete sales forecasts, as they run the risk of having these held up against them in court. So where does that leave you?

Forecast P&L

In most businesses you think in terms of forecast profit, and you are relying on this to live, pay back your debts and basically secure your future. The simplest way (in my view) of looking at a forecast profit and loss is as follows:

Sales revenues – very hard to predict

Less Costs

Cost of goods sold
(factor of sales revenue)

Rent – fairly predictable cost

Wages – fairly predictable cost
(with some variable component)

Other (power, phone, all fairly small)

= PROFIT

Whilst most of the costs are fairly predictable, and the cost of goods sold is a factor of the total revenue, the sales revenue is the most unpredictable factor in a simple Forecast P&L.

If any of the other factors are out by a small percentage, there is a relatively small effect on the PROFIT (up or down).

If the sales revenue is out by a fair percentage, say plus or minus 50 per cent, then the effect on the bottom line is either fantastic or catastrophic!

So, ‘how do we do a good estimate of future sales?’ is the “\$64,000 question!

Research – the analogue approach

The simplest way to guesstimate sales is what I call the ‘analogue approach’. This means, think of your future store or business, and look for similar stores or businesses in similar situations. Then try and find out what their sales revenues are, and use that

as the basis for forecasting your own.

An example may be that you are going into a food court of a shopping centre, and the franchisor has 10 other stores in similar situations. Shopping centres are normally measured with a few main factors:

- GLAR – Gross Leasable Area Retail – or how many square metres is the Centre?
- MAT – Moving Annual Turnover – total \$ transacted in a 12 month period.
- Seats in the food court
- Number of cinema screens

And then quite a few other factors.

This information is available from books called Shopping Centre Directories through the Property Council of Australia, and most large franchisors should have this information.

If, for example, you are going into a shopping centre of 70,000 sq m (GLAR) and has a MAT of \$300M, and 600 seats in the food court, and no theatre screens, then finding out if similar shopping centres exist, and if the franchisor has sites in them, is a good start.

Normally you will not find exactly the same analogue, but you can look for, say, two variables that are similar to the shopping centre you are considering, and the first two I would suggest are GLAR and MAT.

In shopping centre terms, centres are grouped using the Property Council

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definitions by their GLAR as follows, and these are a good start to ‘compare apples to apples’:

- Super Regional Centres
85,000 + square metres
- Major Regional Centres
50,000 – 85,000 square metres
- Regional
30,000 – 50,000 square metres
- Sub Regional
10,000 – 30,000 square metres
- Neighbourhood
< 10,000 square metres

Basically if you are going into a regional shopping centre, don't compare sales you would expect, to those coming out of the super regional centres, and hopefully the rentals will be less as well.

The franchisor will suggest you do your due diligence, and one of my suggestions, is to talk with franchisees in similar types of centres, not only about the franchise system, but also about their sales expectations.

From a franchisor's view, they should be able to do quite a deal to give themselves comfort in approving a store. Whether they are at liberty to pass that on, is up to them.

If you have a network of stores, you can learn from their sales history. As a franchisor, you should have their sales, and be able to bring together other information to explain why the good stores are good... and why the poor stores are acting that way. In some cases it may be the franchisee, however in other cases, Superman could not run it at a profit!

More statistical methods

As a potential franchisee you may have reached your practical limit with the logic above. However if you are a franchisor, or a master franchisee with multiple stores, you can do it better!

Regression modelling is a proven statistical technique that looks at which individual factors contribute positively

or negatively to a store's performance.

Once the strongest individual factors are identified, these can be combined by statistically trained people to create a prediction model.

As an example, in a gift shop chain in shopping strips, you may have concluded from simple regression that the main positive and negative variables for your sales are:

1. Number of households within 3 km radius is a positive.
2. Higher household income is a positive
3. Size of shop is a positive
4. Number of retail shops in the strip is a positive
5. Number of Coles or Woolworths supermarkets in the strip is positive
6. Section in strip – Busiest, middle, quietest section - rated (3,2,1) is positive
7. More gift shops in the shopping strip is a negative

If we only have a small number of stores to work with – say 15 stores in the network, we can really only create a check chart.

If we have a large network of maybe 40 plus stores, we now may have a multiple regression model which may look something like:

Monthly Sales \$ = 2.55 X number of households + 1.28 X average household income within 3 kms
+ 256 X sq m of store
+ 25 X number of shops in the strip
+ 2,567 X number of Coles + Woolworth Supermarkets
+ 5,400 X rating of section of strip
- 3,233 X number of other gift shops in the strip

This will deliver a sales prediction, and this is tested by looking at each individual store, and how closely the sales predictions are to the actual sales.

The closer they come to the diagonal line, the better the prediction model.



As a potential franchisee, it is comforting to know your franchisor uses some statistical process before they approve the site you are placing your capital in. Whilst they may not be prepared to show you their internal workings and calculations, confidence in the process they use should help in making good decisions for both parties.

Summary

Your sales estimate is the number you will be building your business plans around, and the better the logic and the process that generates this, the higher the chances of your business meeting your expectations.

As a franchisee you cannot access all the resources your franchisor has, but you can use an analogue process to at least give yourself some logic in what sales revenues you should generate in your new business venture. ❖

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