FRANCHIZE CONSULTANTS

FRANCHISING CONFIDENCE INDEX

Release Date: **14 February 2023**

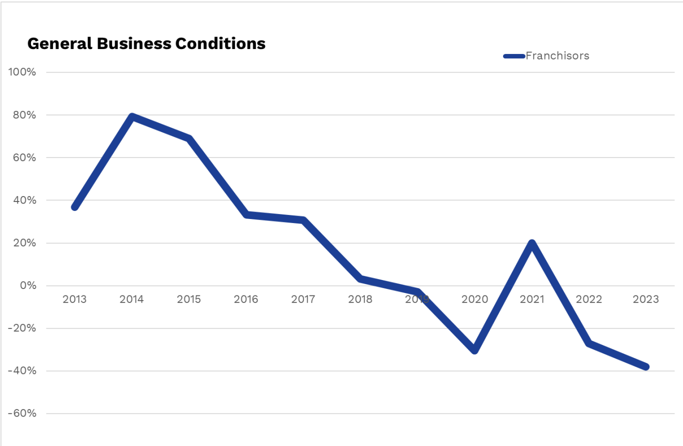
Franchisors See Another Challenging Year

Franchize Consultants' January 2023 *Franchising Confidence Index* sets the stage for the year, with 30 franchisors providing a window into current and more long-term opportunities and challenges.

Franchisors are expecting another tough year ahead with net sentiment being negative on six out of the nine survey measures. Access to financing and franchisee operating costs measures remain at an all-time low - with the lowest net confidence recorded since the Franchising Confidence Index started in 2010. Compared to 2022, franchisor outlook on general business conditions continues to decline from a net negative 27% to net negative 38%.

When asked how things are looking, some are positive and upbeat citing strong demand for their products and services. Meanwhile, many expect a challenging year with major issues finding suitable staff, inflationary pressure on operating costs and declining margins.

General Business Conditions



Franchisor outlook for general business conditions showed further deterioration to net negative 38% in January 2023 from net negative 27% in January 2022.

This weaker confidence from franchisors mirrors other research with general businesses. The latest ANZ New Zealand Business Outlook showed business confidence at net negative 52% in January 2023. Similarly, the NZIER Quarterly Survey of Business Opinion shows business confidence falling in the latest quarter with a net 73% of businesses expecting a deterioration in general economic conditions over the coming months.

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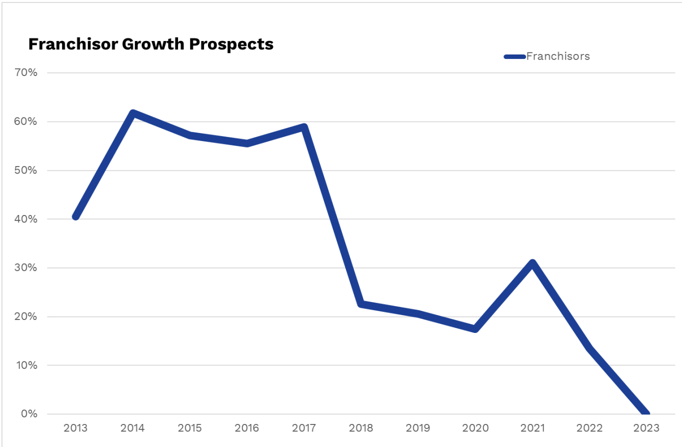
RESULTS SUMMARY TABLE *

	Franchisors										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
General business conditions	37%	79%	69%	33%	31%	3%	-3%	-30%	20%	-27%	-38%
Access to financing	13%	9%	41%	30%	-8%	0%	-18%	-30%	-30%	-70%	-70%
Access to suitable franchisees	5%	0%	17%	0%	10%	-28%	-24%	-30%	23%	-27%	-23%
Availability of suitable staff	-5%	3%	-18%	-7%	-3%	-16%	-31%	-36%	7%	-78%	-14%
Availability of suitable locations	-5%	0%	12%	-16%	16%	7%	-3%	9%	14%	9%	13%
Sales levels per franchisee	32%	65%	62%	52%	56%	28%	26%	39%	13%	0%	13%
Operating costs per franchisee	-11%	-18%	-3%	-19%	-13%	-39%	-56%	-43%	-40%	-73%	-73%
Franchisee profitability levels	13%	38%	38%	44%	44%	9%	-12%	0%	-7%	-43%	-13%
Franchisor growth prospects	41%	62%	57%	56%	59%	23%	21%	17%	31%	14%	0%

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

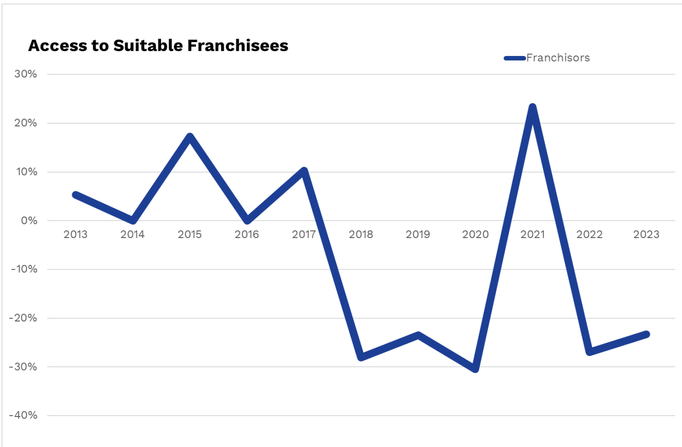
Franchisor Growth Prospects

Franchisor sentiment for their growth prospects softened to net 0%, from net 14% in 2022.



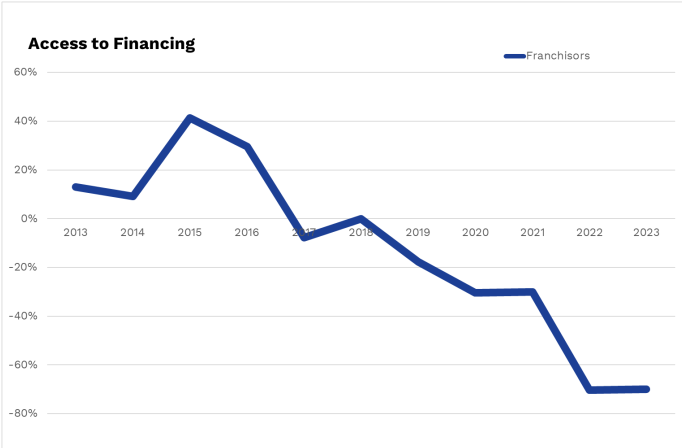
Access to Suitable Franchisees

Franchisor sentiment towards access to suitable franchisees remains at a similar level from 12 months ago at net negative 23% from net negative 27% in 2022.



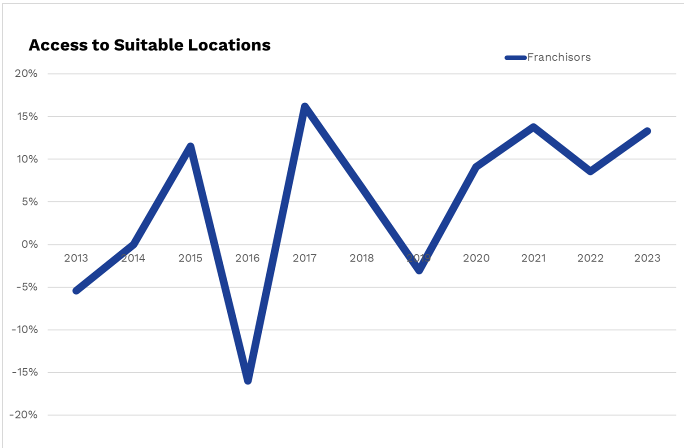
Access to Financing

Franchisor sentiment towards access to financing remains at an all-time low at net negative 70%, the lowest net confidence recorded since the Franchising Confidence Index was established in 2010.



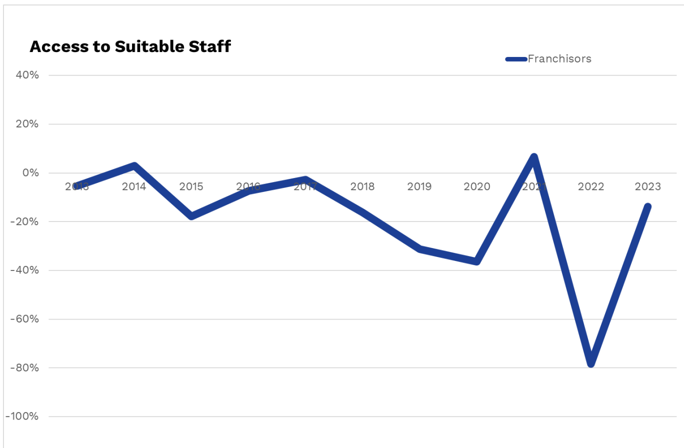
Access to Suitable Locations

Franchisor outlook on suitable locations remains largely unchanged at net 13% from net 9% in 2022.



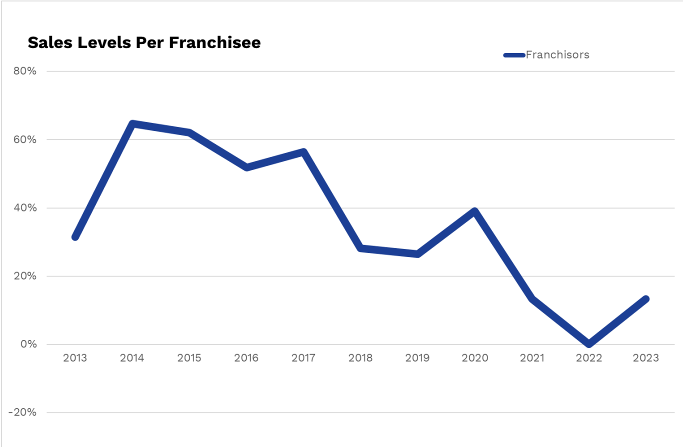
Access to Suitable Staff

Franchisor outlook towards access to suitable staff improves (whilst still remaining negative) to net negative 14% following a strong decline to net negative 78% in 2022.



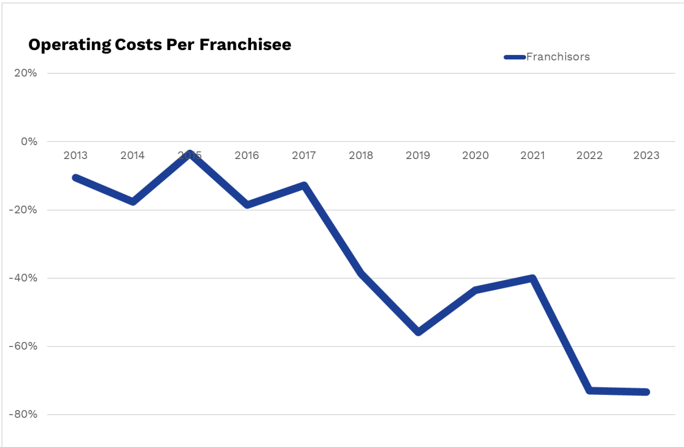
Sales Levels Per Franchisee

Franchisors sentiment towards future sales levels per franchisee shows a hint of positivity at net 13% from net 0% in 2022.



Franchisee Operating Costs

Franchisee operating costs remain a concerning area – with franchisors sentiment at net negative 73%, no change from last year.



Franchisee Profitability Levels

Franchisor outlook on franchisee profitability levels improves from net negative 43% in 2022 to net negative 13% in 2023.

Franchising Outlook

Franchisors were asked for qualitative responses on how things were looking in their sector. 30 franchisors responded from a variety of self-reported industries such as construction, retail, hospitality, home services, education, and health and fitness.

Some franchisors, depending on the sector they operate in, are positive and upbeat with strong demand for their products and services. On the other hand, some franchisors are expecting a challenging year ahead with major issues with finding staff, inflationary pressure on operating costs and squeezed margins.

The following comments are indicative of this sentiment:

Construction

- *Flooring is still booming. Some of the newer stores and shops in locations with aging population are feeling the pinch a little more.*
- *Building still good.*
- *Downturn in construction means upturn in people looking for something.*
- *Building and construction may present some challenges this year however our teams are looking at different segments of the market that require specialists or accredited installers to create specific niches to support us when leads in the market decline in line with building consents. People will look to spend money on their homes rather than to travel.*
- *We are OK and are getting good growth but with rising costs it will be an interesting 12 months.*
- *We are still seeing similar levels of enquiry but have definitely seen a decrease in conversion rates (lead to confirmed work) for our franchisees in the last quarter of 2022.*
- *If recession hits, customers will put off preventative maintenance and only do essentials - seen trend with the GFC.*
- *Grim.*

Retail

- *Margins are being squeezed with excise and supplier increases (local and international). Staff is a major issue with changes to immigration. Duty free and on premise are having a resurgence after COVID lockdowns is impacting spirit sales.*
- *Inflationary pressures on costs including wages and logistics.*
- *Lack of suitable staff.*
- *Looking positive.*
- *Expecting sales to remain similar to the last year.*

Hospitality

- *I see the hospitality industry hit the hardest again in the coming year as staffing becomes harder and rent increases are passed on with the CPI annual reviews.*
- *There are numerous good parts. Staff and costs are an ongoing struggle.*

Home services

- *Our service is in demand and our sector continues to grow.*
- *Cannot find franchisees, more work than we can handle.*
- *Significant challenges with high interest rates and labour shortage. Legislation changes also presenting difficulties, although will impact whole industry and not us specifically.*

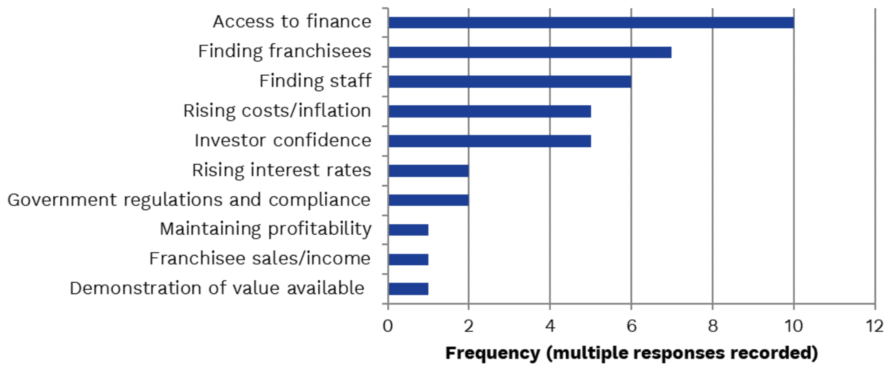
Others

- *Education. Strong as so much disruption from pandemic.*
- *Fitness and Wellness. We think the sector will be able to absorb the economic recession. People place high importance on their wellness. We see it will create opportunities for our sector to provide more services and a low price point then what a customer might collective be paying for a range of services. We can consolidate our offering to incorporate what they are currently paying for at a cheaper price point, which is still profitable for us.*
- *B2B. Very solid demand. Enjoying good double-digit growth this financial year. Labour supply remains biggest challenge to franchisees.*
- *FMCG. Solid. We've had an incredible year with record growth, and this year we should bed that in and hold sales.*
- *Accommodation. Forward bookings to 180 days out are looking positive.*
- *Food Distribution. Extremely busy with lots of growth.*
- *As consumer spending tightens, second hand products and prices may become more appealing.*
- *Strong growth opportunities exist.*
- *Rising costs and falling sales are a potent mix.*
- *Staffing is still a problem but hopefully will get better.*
- *The outlook is mixed. Two primary differences are the positive changes within the wholesale market; however, the limitation of tobacco retailers will prove to be detrimental.*

Greatest Challenge to Franchising Development in 2023

We asked franchisors what they perceived to be the greatest challenge to franchising development in the year ahead. The following chart plots the frequency of key themes from the comments.

GREATEST CHALLENGE TO FRANCHISING DEVELOPMENT



10 of the 29 franchisors who responded to the question identified access to finance as the top challenge to their development. This is followed by finding suitable franchisees and staff with 7 and 6 franchisors respectively identifying them as a challenge.

Other challenges highlighted by franchisors include rising costs, weak investor confidence, rising interest rates and government regulations and compliance.

Previous Year Comparisons

Access to finance, finding suitable franchisees and staff, and rising operating costs continue to be the key areas of concern for franchisors. Weak investor confidence, which was last identified as a key challenge in 2012, is seen to be a concern again in 2023 as prospective franchisees perceived a challenging operating environment for businesses.

TOP 5 CHALLENGE RANKINGS

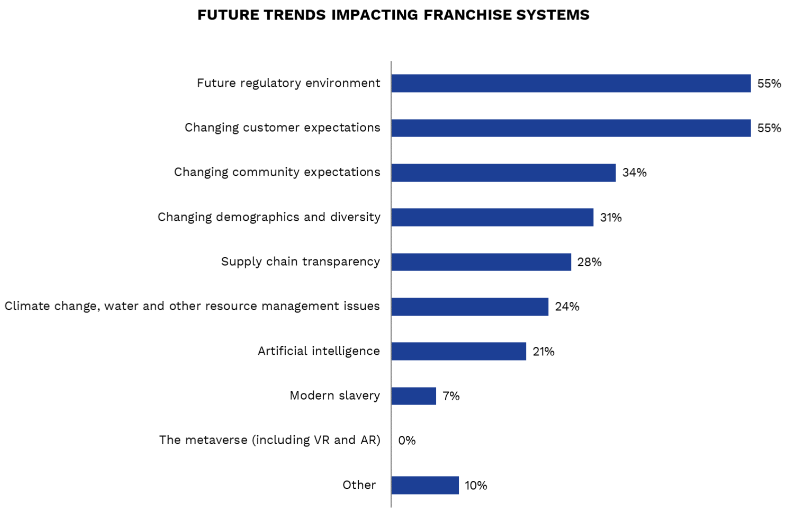
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Finding Franchisees	1	1	1	1	1	1	1	1	1	4=	3	2
Access to Finance	2	5			4			3	3=	2=	4	1
Economic Concerns	3	3	2		5	4	4=	4=				
Investor Confidence	4											4=
Finding Suitable Locations	5		5	5	2				3=			
Franchisee Business Model Challenges		2				5	4=					
Online Retail Threat		4										
Franchisee Business Execution			3									
Finding Suitable Staff			4	2		3		2		2=	1	3
Operating Costs / Franchisee Investment				3	3	2	3	4=	3=	4=		4=
Competition				4								
Increasing regulations and compliance							2		2		5	
Covid impact / Uncertainty										1	2	

What Will Provide the Greatest Opportunity Related to Franchising Development in 2023?

This year we once again asked franchisors what they perceived to be the greatest opportunity related to franchising development in the year ahead. Key themes identified include better availability of premises/sites (potentially with better terms), a focus on reducing costs and improving labour efficiency, launching new products, developing existing franchisees into multi-site owners, and securing work for franchisees with national coverage. Some franchisors feel the slowdown in the economy may lead to instability in jobs and redundancies generating more enquiries for franchising.

Major Future Trends Impacting Franchise Systems

This year we asked franchisors to identify the future major trends that are most likely to impact on their business in the next 5-10 years from a list of options provided. The chart below illustrates the responses from franchisors with the future regulatory environment and changing customer expectations identified as the top major trends impacting franchise systems in the next 5-10 years. Other notable trends include changing community expectations, changing demographics and diversity, supply chain transparency, trends related to climate change, water and other resource management issues, and artificial intelligence.



Concluding Comment

The current operating environment and associated outlook is clearly tough for many businesses and franchise systems with high inflation and climbing interest rates over the last 12 months, and the prediction of a recession in 2023.

It is therefore not surprising Franchize Consultants' *Franchising Confidence Index* in 2023 indicates growing challenges for franchisors and franchisees alike with franchisor outlook on general business conditions falling to net negative 38%. Franchisors were particularly pessimistic on access to financing and franchisee operating cost levels while finding franchisees and suitable staff remain a challenge.

While franchisor sentiment on general business conditions may be in line with other New Zealand business surveys, we suggest franchisors should, if not already, be considering taking any opportunity to review and improve their franchise business model, associated franchise structure and management. Changes that can improve the outlook for franchisee and franchisor value creation are encouraged to strengthen the long-term sustainability of the system.

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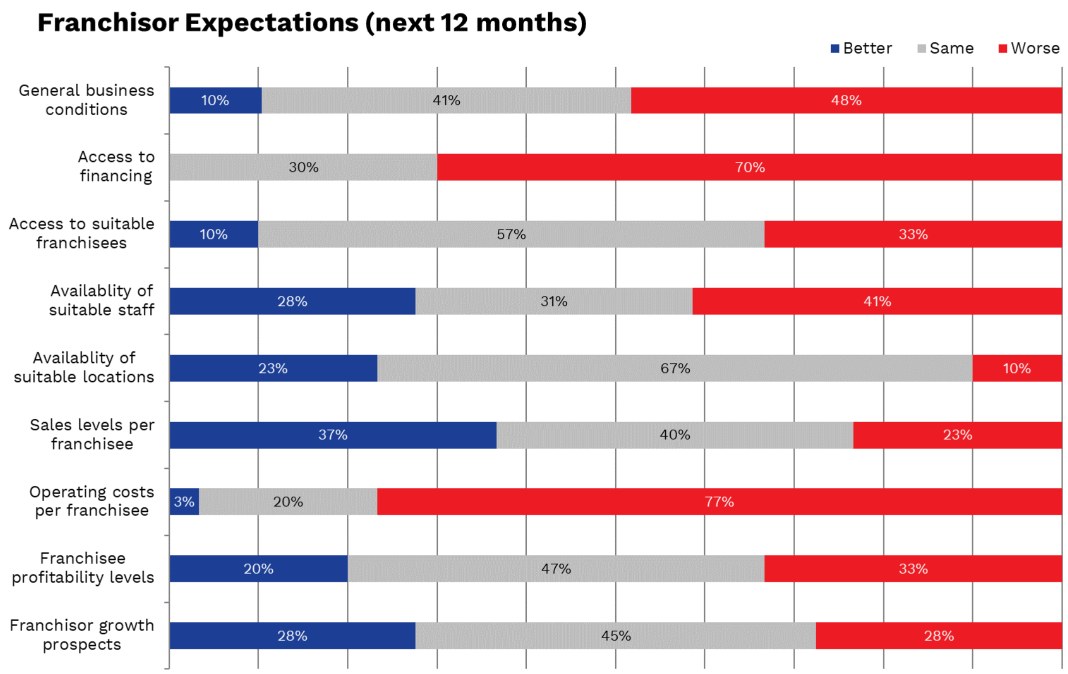
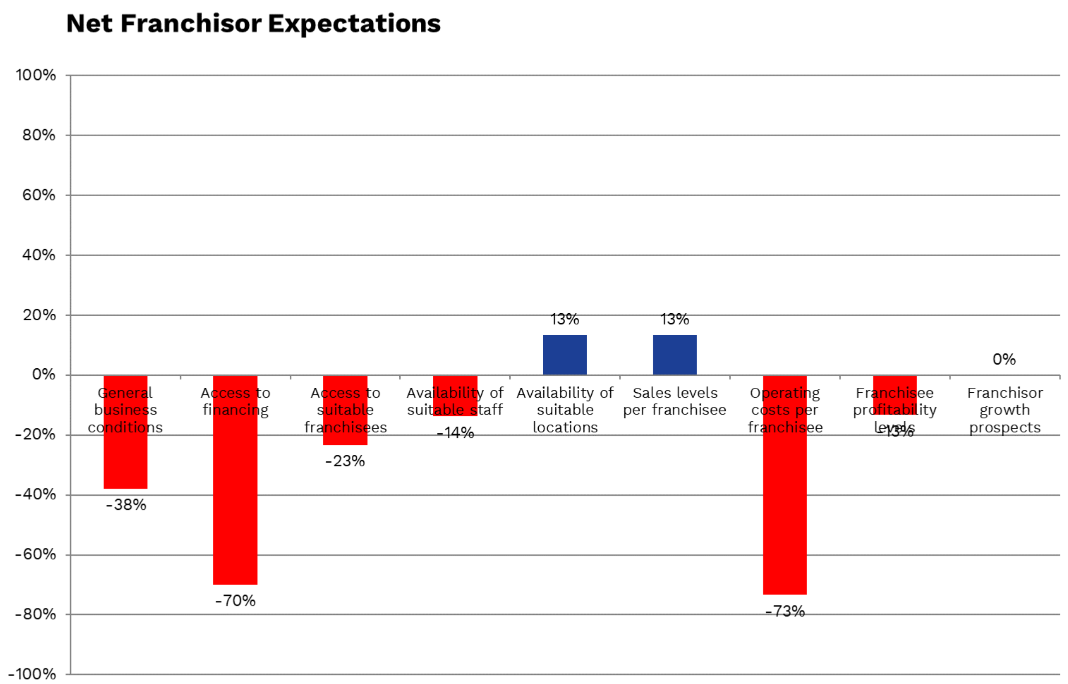
FRANCHISING CONFIDENCE CHARTS

The following illustrations present individual and net franchisor expectations for the following year across all questions, including general business conditions and franchisor growth prospects (covered above).





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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 2021* survey, conducted by Massey University, indicates New Zealand has 590 individual franchise systems comprising some 32,300 units (owned mostly by franchisees). The survey also suggests local franchise systems employ some 156,800 people and total franchise system turnover estimated to be around $36.8 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, MTF Finance, McDonald's, Columbus Coffee, Aramex (formerly 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 30 franchisors collected between 13th and 31st January 2023.

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 views of specialist franchise service providers were also collected as part of the survey but number of responses from this group was too low for it to be reported.

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