Retail Site Selection for Small Business

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Introduction

The mantra of real estate is location, location, location. However, location has vastly different meanings for a business that owns commercial property versus a small retail owner looking to lease a storefront. While the real estate owner is looking for property values and lease rates to increase, the retail store owner is looking for a location that is convenient for potential customers.

To find the best location, retail giants wield GIS systems with customized algorithms crunching census data with years of actual customer preference data combined with geo-demographic databases. The cost of these types of database programs are out of reach of small businesses, much less the teams of statisticians and programmers needed to run them. A quick scan of the Census Bureau web site can generate more data than an owner could ever review, but does that even help?

Making a retail site selection decision is just as important for a small retail owner as it is for major chains. In fact, a small retailer is significantly less able to sustain a bad site decision than is a major retail player. The small or first-time owner is typically undercapitalized and not able to sustain months or years of underutilized business until it can relocate or renegotiate a lease.

What's a small business owner to do and what criteria should they consider? How does a small business owner make a good site selection decision with the limited resources available?

This decision can be broken down into a seven-step process that only requires internet access, a spreadsheet program, a street map and a pack of colored markers. The process is really about identifying the characteristics that are important to your business and gathering the data to find where those characteristics are present. The decision is ultimately a financial decision, but the characteristics that build the financial model are all about your customers' needs and expectations.

The Retail Site Selection Process

Step 1

Create a target customer profile

The most important question to be answered by the business owner has nothing to do with what location is ultimately chosen, but rather who is the customer. Creating a profile of your customers' characteristics allows you to identify where they live, work, play and drive. Think of your customers in census data terms. What is their income range? Is the customer married? Does the customer have children, own a home or drive a car? Identify those characteristics that are present in your target customer. Knowing the characteristics of your customer allows you to more easily target their location.

Step 2

Create a target site profile

Identify the ideal characteristics of your site, the absolute needs and the 'cliff' criteria. 'Cliff' criteria are characteristics or groups of characteristics that are most indicative of potential for failure in your business. Don't be lured by cheap price or great visibility if your potential site has too many 'cliff' criteria present. These factors are usually too difficult to overcome, even by other ideal characteristics. Site characteristics include items such as available parking spaces, building square feet and layout, stand-alone or a strip, ingress and egress and similar characteristics. Identify which characteristics are important for your business. Each business is different and small business owners need to put their personal egos aside to identify site characteristics that are truly important for business success, not personal pride. Rank the importance of each characteristic by assigning a percentage weight. The total of all your percentages should equal 100%.

Step 3

Locate target customers and market keys

Once you know who your target customer is, find them in your area. Sort the demographic data by zip code for your area by using the basic search criteria at the U.S. Census Bureau website. Identify those zip codes or neighborhood areas where your target customer is most concentrated. You may have to get in your car and drive around a zip code area to identify which areas are neighborhoods. Take your map with you and mark where the high concentration of your target customer likely lives.

Also locate the market keys, those items such as major work centers, traffic arteries, recreations areas and retail centers. Once you've identified where you target customer lives, identify driving routes from home neighborhoods to work, shopping and recreational areas. Traffic count data is generally available from your local municipality. Use your markers to identify the high traffic count streets.

Next, identify and note on your map the primary retail centers and feeder businesses. A feeder business is a business where your target customer would also be expected to shop. Identify the location of your primary competition. Whether you want to be close to or far away from your competition depends on your business and marketing strategy. Your map should start to reveal primary trade areas in which the concentration of target customers and market keys start to overlap.

Talk to your city council or plan commission to identify which areas of the city are targeted for future growth and where pending development is planned. Analyze how this information might affect your choice for a location.

Step 4

Identify potential sites within the primary trade area

Now it's time to get some help. Contact a local Realtor with knowledge of the commercial property market to help you identify available sites within your primary trade areas. Visit those sites and generate a list of sites that seem to meet your basic criteria. The Realtor can assemble the financial information associated with each property. These items include lease costs, fees, insurance, common area maintenance charges, property taxes and so forth.

With your target site profile in hand, visit each site during different times of the day and determine a grade for each valued characteristic and 'cliff' criteria. I recommend a 1 – 5 scoring of each item where 5 means the site completely meets your needs. Visiting at different times of the day will help you understand the patterns of customer behavior and whether rush hour traffic renders the site completely unavailable.

Step 5

Rank the potential sites

Utilize the ***Site Ranking Matrix*** (see page 5) or other method, rank the potential sites. The Site Ranking Matrix is a simple model that allows you rank the sites using a weighted average based on the important site criteria and your value of their importance.

Select the top two to five sites for a *pro forma* analysis. You should select the number of sites based on the outcome of your ranking. If two sites score well above the others, use only two. If several are all ranked closely, use that group for the next step.

Step 6

Analyze the financial data

Utilizing the top sites from the Site Ranking Matrix, create a *pro forma* income statement and cash flow for each target site. Each site will have different costs associated with the lease, taxes, insurance and other occupancy expenses. You will also have costs associated with moving expenses and site preparation and build-out. Identify these expenses and quantify the amount for each different site. In addition, each potential site will generate different customer numbers and types that have different impacts on profitability and cash flows. Factoring the differences between the potential sites, create pro forma income statements and cash flows.

If start-up costs for lease buildouts and other items are especially high, consider a net present value analysis of the potential cash flows for each property. Using a three to five year cash flow projection, develop discount rates based on the level of risk involved in your decision, including current interest rates, economic stability and local market growth potential. Using a one-year analysis period places too much emphasis on startup costs, but utilizing a three- to five-year net present value methodology keeps those big lump sum items in the proper balance.

If your start-up costs are relatively low, you can skip the net present value calculations. While a net present value of cash flows almost always gives you a better analysis of the financials, it's fairly complicated math for non-financial people. And frankly, at this point in the evaluation, it should either be clear which property is best or there probably isn't much difference between the top choices.

It's often difficult to compare cost differences between categories and how they will impact financial performance. Different sites have differing potential to generate sales revenue. By combining all factors in a standard business model, the owner can see how the differences in cost and potentials impact the financial performance of the location. A final ranking based on profitability and cash flow will give the business owner a good idea how the different locations will impact the ultimate success of the business venture.

Step 7

Select the best site

A final ranking of the sites based on profitability and cash flow should give the entrepreneur a good basis for selecting a site that will give the business the best chance for success.

For any small business success, the owner must understand how what happens in the business world translates into profitability and cash flow. Creating *pro forma* models helps to quantify the differences in costs and potentials for the various sites. This process will allow any business owner to define what's important to their business success, find those locations that will most likely contribute to their success and compare how the small differences in site and market potential between sites relates to profitability and cash flow.

Summary

Selecting a retail site is more than just scanning the MLS for a good location for your business enterprise. It all starts with understanding your business and your potential customer. A business owner really can't go forward without this information firmly in mind, especially in these times of economic turmoil and financial system distress. If you don't know your business and your customer, you can't develop a proper business or marketing plan and advertising dollars will be wasted promoting your business to customers who will never shop in your store.   Don't let your business's 'cliff' be you.

Site Ranking Matrix

Site: ____

Characteristic	Importance	Site Score	Value
A	0.45	5	2.25
B	0.25	2	0.50
C	0.10	1	0.10
D	0.10	3	0.30
E	0.05	5	0.25
F	0.05	4	0.20
Totals	**1.00**	**20**	**3.60**

Create a site ranking matrix for each potential site like the example above.

1) List the important characteristics for each site in the **Characteristic** column. Replace the letter A – F with the actual characteristic such as visibility, traffic count, parking spaces, ingress and egress and so forth. Use those charateristics that are important to your business. The number of characteristics you use will be determined by your business model. Use as many characteristics as you need.
2) Assign an **Importance** to each characteristic, making sure the importance scores equal 1.00.
3) Score each characteristic for each site based on your visit and information gathering. Use a 1 – 5 scoring for the **Site Score** where the 5 is best and 1 is worst.
4) Multiply the importance by the site score to get the **Value**. Total the value scores to get a total weighted average score for the site.
5) After scoring each site, rank the sites by value, highest to lowest.