Location Selection

LESSON 10

Main Idea

In this unit we will explore the topic of choosing a location for a retail store. We will look at different types of locations for a store and the elements to consider when selecting a location. We will then discuss the merits of buying, leasing, or building a store. We will also examine the types of leases a retailer might consider. Lastly, we will turn to the advantages of locating near a competing or complementary business, dealing with a changing business environment, and math relating to site selection.

After completing this lesson you will be able to:

- List the elements of a good location
- Explain the pros and cons of locating near a competitor
- Discuss the financial impact of buying, building, or leasing
- Calculate rent payments based on different lease terms
- Compare locations and choose the best site for a business

Key Terms

- Shopping Center
- Mall
- Strip Mall
- Business District
- Freestanding Location
- Trade Area
- Traffic
- Competitive Business
- Complementary Business
- Lease
- Fixed-rate Lease
- Percentage Lease
- Triple Net (NNN) Lease

Location is Important

Location is one of the most important decisions a retailer makes. It can make a big difference in the success of a store. There are many factors a retailer must consider before selecting a location, such as the store's target market and the potential location's trading area. A retailer must confirm that the store's target market (the customers the store seeks to attract) shops in the trading area. When studying potential locations, the retailer must consider traffic and convenience as well as the attraction to the target market.

Types of Locations

There are retail store locations in a great many places. Most stores are located at shopping centers, business districts, or freestanding locations. Each of these locations has advantages and disadvantages for different kinds of retail stores.

Shopping Centers

A shopping center is a group of retail businesses that are located together. The shopping center is usually owned by a company that leases retail space to retailers. Malls and strip malls are the two types of shopping centers.

A mall is a containment of stores serving a large area that is usually an enclosed building with an adjacent parking lot. Malls offer the advantage of high traffic flow to a variety of stores with a wide range of merchandise. Many malls feature department stores as well as smaller specialty stores and restaurants. Another advantage of malls is that they are climate controlled.

A strip mall is typically a neighborhood space composed of a group of separate stores that are connected by sidewalks and that have parking lots in front of the stores. An advantage of strip malls is that they are usually located close to residential areas, so they are convenient for customers. They generally contain businesses that customers shop at often like grocery stores, drugstores, dry cleaners, card shops, or shoe repair shops. Another advantage is that leasing a retail space at a strip mall usually costs less than leasing one at a mall.

Business Districts

A business district is an unenclosed shopping area that has evolved without a lot of planning and that features a variety of stores. Parking is usually not provided. The main street of a downtown is a good example of a business district. City governments often renovate downtown buildings in order to attract businesses and customers to the area. The cost of renting a retail space in a business district can vary a great deal depending on the popularity of the area and the other stores there.

Freestanding Locations

A freestanding location is a store that is unattached to other stores. These locations generally have large buildings and abundant parking. For that reason they are usually chosen by large retailers. An advantage of a freestanding location is that it has no direct competition. For this reason, however, the business must be able to draw customers without the help of other stores. Home Depot and Target are examples of retailers that have freestanding locations.

Elements of a Good Location

Retailers evaluate potential store locations by studying several key criteria. A comparison of these factors helps clarify the best location for a particular business. Criteria to consider are as follows:

- **Trade Area**: The trade area is a business's geographic surroundings, which provide most of the customers. This is the most important criterion. You should locate your store in an area that serves your target market. We will discuss target markets in more detail in the Targeted Marketing Unit.
- **Competitive Environment:** Competitive environment describes the proximity of competitive businesses. Nearby competition is often good for a business. Customers feel more comfortable about buying when they can comparison shop. A location that is near a mall or large shopping area can attract customers who are shopping nearby.
- **Traffic:** Traffic is the term used to define the number of people who go by a store location during a given time. The more traffic there is, the greater the number of potential customers entering a store. This is a key advantage of shopping centers.
- **Convenience:** A convenient location is one that is easy for customers to get in and out of. The availability of plentiful and nearby parking is a factor of convenience. Another factor is visibility. Customers need to be able to see the store easily without having to search for it.

- **Additional Factors:** Other factors a retailer might consider are the availability of workers, local zoning laws for the type of business, and the possibilities for expansion of the location.

Competing or Complementing Businesses

A competitive business is one that sells the same or comparable merchandise. We have already noted that nearby competition is beneficial, since customers like to shop around and compare merchandise before buying. Competitors can help attract customers. However, if there is too much competition near a location, there may not be enough customers to keep all the stores in business. A retailer should carefully evaluate the competition in the area before selecting a store location.

A complementary business is one that sells merchandise that is related to, but not the same as, an area business's goods. For example, a furniture store and a home decorating store are complementary businesses. Locating near a complementary business can help attract customers for the mutual benefit of both stores.

Buy, Build, or Lease?

Another decision a retailer must make when considering store location is whether to buy retail space, build a new store, or lease retail space. In most cases, leasing may be the best and only option. Buying space or building a new store requires capital and suitable locations may be difficult to find. This is particularly true if the retailer is considering locating in a strip mall or a mall. Most strip malls and malls are owned by companies that will only make space available through a lease agreement.

Leases

A lease is a contract between a landlord and a tenant for use of a property for a specified amount of time in exchange for a specified amount of rent. Leases have terms that detail exactly what is expected of each party. The terms normally state the amount of rent, the length of the lease, services that the landlord will provide, and provisions for renewing the lease. A retailer should carefully read the lease agreement before signing. It is also a good idea to have a lawyer review the lease agreement.

Types of Leases

There are three main types of leases that are used for most retail situations. These are the fixed-rate lease, the percentage lease, and the triple net lease.

Fixed-Rate Lease

A fixed-rate lease is one that charges the tenant a specific amount of rent each month. This is an advantage for the retailer since the amount of rent does not vary, which makes financial planning much easier. It is worth noting that this type of lease is not widely used.

Percentage Lease

A percentage lease is one that is used often. This type of lease bases the amount of rent on a percentage of the sales generated in the space.

Some percentage leases have a maximum allowable rent while others use a sliding scale. Rent on a sliding scale normally goes down as sales go up; for example, a retailer might pay 4% on sales up to $100,000 and 3% on sales over $100,000. Percentage leases often charge an additional maintenance fee on top of the rent.

Triple Net (NNN) Lease

A triple net (NNN) lease is one that charges the tenant rent plus the three operating costs of the rented property. Those costs are for insurance, maintenance and utilities, and property taxes. The tenant pays rent as either a fixed amount or as a percentage of sales. This type of lease provides the landlord with a net rent because the tenant pays for the property's expenses. This is a popular type of lease.

Changing Business Environments

When selecting a location for your business, it is important to study the business environment. The business environment forecasts whether the location under consideration is likely to experience economic growth or suffer an economic downturn. To study the environment, a retailer should examine the current demographics and employment rates of the area, as well as projections for the future. A good resource for this information is your local chamber of commerce. This information will reveal whether the business's target market and employment rate will remain constant or whether it will change during the time of the projections. A change in target market and employment trends can mean that you will need to adjust merchandise offerings to suit changing customer needs or risk suffering declining sales.

Summary

In this unit we have learned about the importance of store location and the types of store locations. We also studied the elements of a good location. We then looked at competing and complementary businesses, reviewed the three types of business leases, and discussed potential changes in the business environment. Lastly, we reviewed some of the mathematics associated with choosing a store location.

Key Math Concepts

COMPUTE THE AMOUNT OF A PERCENTAGE LEASE
To compute the amount of a percentage lease, change the percent to a decimal and then multiply this number by your sales.

COMPUTE THE ANNUAL AMOUNT OF A FIXED-RATE LEASE
To compute the annual amount of a fixed-rate lease, multiply the amount of monthly rent by 12.

COMPUTE THE AMOUNT FOR THE LENGTH OF THE LEASE
To compute the amount for the length of the lease, multiply the annual rent by the number of years in the lease.

Key Terms

Shopping Center
A group of retail businesses that are located together.

Mall
A containment of stores serving a large area that is usually an enclosed building with an adjacent parking lot.

Strip Mall
Typically a neighborhood space composed of a group of separate stores that are connected by sidewalks and that have parking lots in front of the stores.

Business District
An unenclosed shopping area that has evolved without a lot of planning and that features a variety of stores.

Freestanding Location
A store that is unattached to other stores.

Trade Area
A business's geographic surroundings, which provide most of the customers.

Traffic
The term used to define the number of people who go by a store location during a given time.

Competitive Business
One that sells the same or comparable merchandise.

Complementary Business
One that sells merchandise that is related to, but not the same as, an area business's goods.

Lease
A contract between a landlord and a tenant for use of a property for a specified amount of time in exchange for a specified amount of rent.

Fixed-rate Lease
One that charges the tenant a specific amount of rent each month.

Percentage Lease
One that bases the amount of rent on a percentage of the sales generated in the space.

Triple Net (NNN) Lease
One that charges the tenant rent plus the three operating costs of the rented property.

Location Selection

1. You have the opportunity to lease space for your business with a fixed-rate lease. The property owner has proposed a five-year lease with a rent of $4,000 per month. How much is the rent per year? How much is the rent over the life of the lease?

2. You are considering leasing a store site that has 1,500 square feet. The landlord is asking for a rent of $50 per square foot, per year. How much is the rent per year? How much is the rent per month?

3. The terms of a percentage lease state that rent is 4% of sales up to $100,000 and 2.5% of sales over $100,000. Your business plan projects monthly sales to average $270,000 per month. There is a $250 per month maintenance fee. What do you project as an average monthly rent? What do you project as an average annual rent?

4. You are considering leasing one of two store sites of equal size. The first site features a percentage lease of 4% of sales per month. The second site features a triple net lease with these monthly terms: rent is 3% of sales, insurance is $175, maintenance is $50 and utilities total $345, and property tax is $165. Your business plan estimates your monthly sales to average $85,000. Which lease is better for you financially?

WRITTEN EXERCISES **LESSON 10**

Location Selection

1. Describe the three major types of business locations, and describe three different types of stores that might be in each location. Then list reasons why you think these locations are appropriate for each type of store.

2. Explain the differences between a strip mall and a mall. List the advantages of each location. Then describe an example of each in your area.

3. Choose a retail store you would like to own. Select two potential sites within five miles of your school. Using the elements of a good location, evaluate and rank the potential sites; then defend your selection.

4. Think of your favorite store. Describe the store, its merchandise, its size, and its location. Explain the reasons why you believe the location is good for the store.

COMPUTER EXERCISE

Location Selection

LESSON 10

GOAL: Your goal is to select the best location for you store. You will analyze several location choices and compare them across four attributes.

YOUR SITUATION: In the lesson, you do not control any actions but will analyze several locations.

1. Run the **Open New Store**, **Run To**, and **Population** sections of the **Tutorial**.
2. Fill in **Worksheet 1** for four locations that are labeled A through D. Rate each location as high, medium, or low for each category. For "Cost" use **Actions->Open Store** to check the rent on each location. For "Availability of Signage" observe the number of Apartments, Offices, and Senior Housing around each location. Use the Building Types key to determine which building is which.

QUESTION 1: Which is the best location and why?

3. Using **Options->Run To**, run the simulation to April 1st and watch the population change. Note: Population change and construction has been accelerated for demonstration purposes.

QUESTION 2: What has changed? Would your choice for a best location be different now? Why?

WORKSHEET 1

Location	Customers/Traffic	Competitors	Cost per Month	Availability of Signage
A				
B				
C				
D