Chapter 8

Location and Facilities

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Objectives

8-1 Explain the role of convenience in choosing a location for a business.

8-2 Differentiate the three categories of consumer goods.

8-3 Describe the location options available for retail businesses, industrial businesses, professional offices, and home-based businesses.

8-4 Discuss various aspects of commercial leases.

8-5 List the advantages of buying a commercial space.

8-6 Explain the importance of properly evaluating potential facilities and their surrounding environment.

THE IMPORTANCE OF CONVENIENCE

You may have heard that the three most important ingredients in starting a successful business are location, location, location. Although this statement is somewhat exaggerated, for some businesses it holds much truth. Choosing the proper location is one of the most important decisions an entrepreneur makes.

Our society demands convenience. Driving along a busy commercial strip with its fast-food restaurants or visiting a super-sized shopping mall gives you an idea of the extremes businesses go to in order to be accessible to their customers. The question is no longer whether to eat pizza but rather from which pizza restaurant to order and whether to go to the restaurant to eat it, pick it up, or have it delivered. The entrepreneur who understands the importance of being in the right place at the right time is the one most likely to succeed.

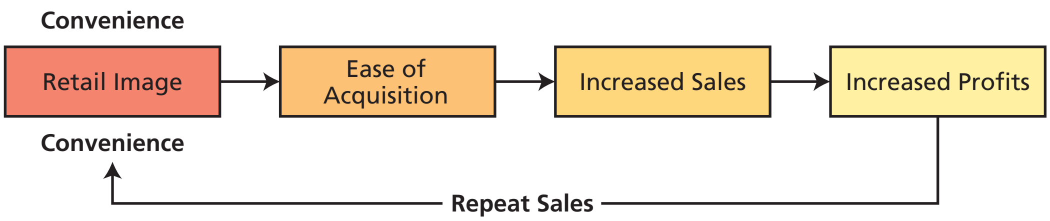
Entrepreneurs must understand the relationship, or correlation, between time and place. Whether the prospective purchases are consumer goods or services or industrial products, customers' decisions are affected by what they perceive to be convenient. Making a business convenient intensifies the consumer's desires. If it is convenient to buy pizza, people will buy more. If they have to drive 5 miles to buy pizza instead of 1 mile, they will buy fewer pizzas.

Convenience saves time, and time is finite. Time cannot be created or extended. There are only 24 hours in a day. In increasingly busy lives, saving time has become very important. By offering convenience, the entrepreneur saves time for the consumer, thus persuading the consumer to buy more.

Americans have grown accustomed to obtaining goods with little effort. If you are pressed for time and cannot easily find what you want, you often buy substitute goods or services. Many businesses profit from consumers' time limitations. Fast food restaurants are a good example. The tremendous growth of the fast food industry occurred when women started to enter the workforce in greater numbers. Because of the hectic lifestyle of the dual-career family, it became more convenient to go through a drive-through window on the way home from work or order a home-delivered pizza.

Saving time is often worth money to customers. Time becomes a commodity for which they are willing to pay. Certainly it is less expensive to buy basic grocery items at a supermarket than at a convenience store. But in a convenience store, customers are paying for the convenience, which provides the merchant with a higher markup. Figure 8-1 illustrates what happens when a business is perceived as more convenient than its competition.

FIGURE 8-1 *Convenience Theory*



Time and convenience are responsible for the growth of many other industries, such as catalog sales and vending machines. Internet sales have surged because Internet shopping is convenient and saves time and travel. Time is also why small manufacturers can compete successfully with large manufacturers, as they are often able to deliver goods faster. It is very important to have the right assortment of goods and the right image, but if the goods are not easy to acquire, the business will not succeed.

TYPES OF CONSUMER GOODS

To determine the best location for selling consumer goods and services, entrepreneurs must first classify their products as one of three types of goods—convenience goods, shopping goods, or specialty goods.

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Convenience goods are products that people expect to find in many places. They are readily available in a variety of stores, including convenience stores, drugstores, and grocery stores. It is imperative that a business that sells convenience goods be accessible to large markets.

Shopping goods are products that are also easily found, although they are not as widely distributed as convenience goods. They are normally available in all communities in sufficient quantities to meet average consumer needs. Tires, jewelry, popular fashions, and compact discs are examples of shopping goods. Purchase of these products often requires going to a particular type of store and usually involves more planning and decision making than does the purchase of convenience goods. Consumers often comparison-shop for these products, looking for the best value. To sell shopping goods successfully, businesses must be convenient to intended markets.

Specialty goods are products that people are willing to go out of their way to buy. The purchases are usually planned in advance. Wedding dresses, cars, and computers are examples of specialty goods. Since these are usually major purchases, the consumer does not mind taking extra time to get the best product. Success in specialty goods sales requires that the business be accessible, that potential customers know its location, and that it is located in an area that is compatible with the image of the product or service.

CHOOSE A BUSINESS LOCATION

The first decision you need to make is which community will be the best one for your business. Completing a demographic study will help to determine this (see Chapter 5).

If the demographics of your local community support your business idea, you would be wise to locate there for several reasons.

1. You will be working in a familiar area.
2. There will already be a small nucleus of customers in place, made up of friends and acquaintances.
3. You may know bankers, attorneys, or accountants who would be part of an important support system for your new business.

The grass might look greener in another community, but your hometown is often the best bet. Once you have chosen the community, you can consider specific location possibilities.

Retail Businesses

A wide variety of shopping areas offer different advantages and drawbacks, depending on the type of retail business you are starting.

Downtown Shopping Districts In the past, the downtown area of a town or city was where the commercial activity was centered. Almost everyone worked and shopped downtown. After World War II, however, a population shift toward suburban areas began. More and more people chose to reside outside of cities, so retail establishments started to move to these areas as well.

Small Business Technology

Telecommunications technology has been a great advantage to small business owners. With affordable long distance telephone rates, e-mail, and faxes, small businesses can communicate with their customers as easily as large businesses do. Potential customers cannot tell if the communication comes from the skyscraper office of a large company in New York City or John Smith's home office on Cherry Street. Transactions also occur more quickly than ever before. Inquiries can be made and answers received in a matter of minutes.

Suburban shopping areas began as small shopping centers and grew into major shopping complexes. Downtown stores branched out to the suburbs and left the downtown areas in many communities almost deserted. In recent years, many cities have recognized the deterioration in their downtowns and have made efforts to reverse it. It is often difficult to rebuild these areas because of parking problems and limited shopping hours, but many towns have managed to create attractive downtown shopping districts.

Locating in a downtown shopping district offers certain advantages to business owners, the chief one being the lower cost of doing business. Since the buildings are often older, rental costs may be considerably lower. Also, the hours of operation are often shorter than in suburban malls, which reduces operating expenses. However, when considering a downtown location, the entrepreneur must identify any disadvantages, such as parking limitations, as well as the overall suitability of the facility. Although many of today's shoppers prefer evening shopping, if the downtown area is active during the day and the surrounding businesses are well maintained, it is certainly a location worth considering. College towns, tourist areas, and active commercial districts make attractive downtown locations.

FUN FACTS

The Country Club Plaza in Kansas City, Missouri, is considered the country's first shopping center. The Plaza opened in 1924 as the first shopping area specifically designed to accommodate automobiles.

Shopping Centers Shopping centers have come a long way since they first appeared, primarily after World War II. There are four classifications of shopping centers, and each is indicative of the market it serves.

Neighborhood shopping centers often have a supermarket and small service and convenience goods stores. The customers are nearby residents who shop in these centers for convenience. The population density of the surrounding residential areas determines the amount of activity. Rental expense is usually reasonable. Businesses that sell mainly convenience goods or services can be profitable in these shopping centers.

Community shopping centers are designed to serve residents of many neighborhoods. Although rents are higher than in neighborhood shopping centers, locating in community shopping centers can mean more profit for businesses that sell shopping goods, convenience goods, or both. Normally, these centers have at least one, and often two, major tenants called **anchor stores**, and 20 or more smaller stores. Anchor stores, which are often department stores, large discount stores, supermarkets, or drugstores, advertise

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actively and attract customers from an entire community. The smaller stores attempt to attract those customers as well, often as they walk by, comparison-shopping between the anchor stores.

Regional shopping centers are designed to attract customers from a region, or more than one community. These larger shopping areas usually have three or more anchor stores and more than 50 other stores and are often enclosed malls. A regional shopping center or mall offers convenience, shopping, and specialty goods, but because renting the space is expensive, the products offered often have a higher **profit margin** than most convenience-goods stores can support. The profit margin, or markup, is the difference between the cost of a good or service and its selling price.

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The entrepreneur who sells shopping goods or specialty goods and needs substantial pedestrian traffic to be successful might want to do business in a regional shopping center, but the high cost of operation adds to the risk of starting a business.

Super regional shopping centers are found in major metropolitan areas and may contain more than a hundred of the most contemporary stores. For example, the West Edmonton Mall in Edmonton, Canada, and the Mall of America in Bloomington, Minnesota, each has approximately 800 stores. These giant complexes also feature entertainment facilities, such as skating rinks, miniature golf courses, hotels, and amusement parks. The Toronto Blue Jays' baseball stadium is attached to a shopping mall. Stores in these centers are extremely expensive to operate and are not usually recommended for new business owners. Most tenants are chain operations that can make large investments in their operations.

Big box store centers are being developed in medium and larger communities. These centers comprise very large shopping goods stores that sell in great quantities, usually at discounted prices. Stores such as Best Buy, Circuit City, Barnes & Noble, and Toys "R" Us, which offer a complete selection of their industry's products, have found a profitable platform of operations in such locations. They are not the best choice for smaller stores, but strip shopping centers are often located near box stores and take advantage of the traffic they create.

Discount outlet centers have also become more widespread, but these stores are usually owned by the manufacturer of the products they sell, and are therefore not an option for start-up entrepreneurs.

If the new business is to be located in a shopping center, the entrepreneur must research the advantages and disadvantages of each type. For example, the high cost of a large center is offset by its appeal to customers, and, theoretically, more people shopping means more chances to sell. Also, if paying more rent gives the business greater exposure, the business will not have to spend as much money on advertising. Malls and shopping centers charge rent based on traffic flow. A store in a high-traffic mall will cost more than one in

FIGURE 8-2 *Shopping Center*

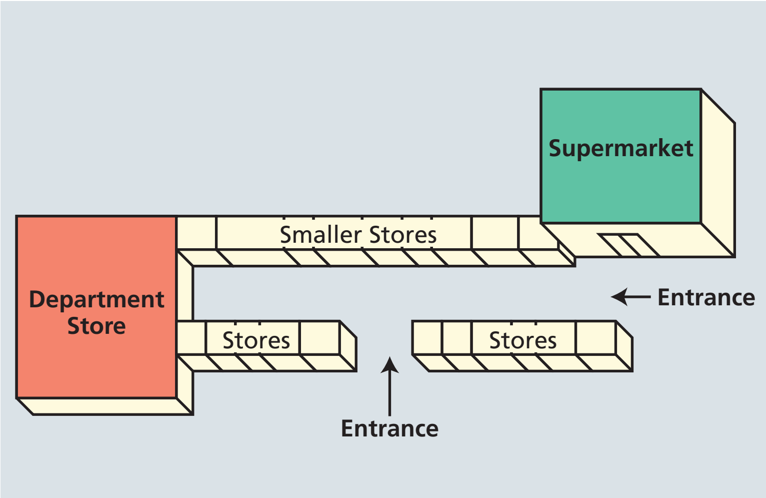
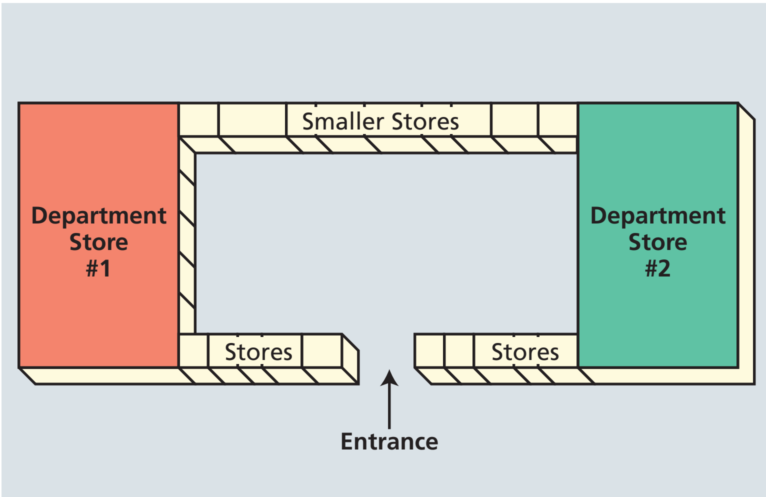


FIGURE 8-3 *Competing Shopping Center*



a low-traffic mall. Entrepreneurs must determine whether the extra traffic will generate enough additional sales to offset the higher rent. Stores that depend on a large number of fairly low-cost transactions must locate where there is a high volume of pedestrian traffic. Also, larger shopping centers usually have larger advertising budgets.

"You get what you pay for" is often true when it comes to choosing a retail location. Two shopping centers that appear to be very similar in makeup might be quite different in traffic flow, as illustrated in Figures 8-2 and 8-3. Suppose two community malls were located within a mile of each other on the same side of the same busy highway. One is anchored by two major department stores, the other by a major department store and a major supermarket chain store. Both shopping centers have approximately 55 stores and the same tenant mix of smaller stores. The shopping center with the two department stores rents for $25 per square foot base rent, and the other center rents for $20 per square foot. If you were considering a 1,500-square-foot store, the difference in base rent would be $7,500 per year ($30,000 versus $37,500). That $7,500 could be used to buy additional inventory, which could produce more sales. But look closely at the traffic flow. The two department stores create a constant cross flow of traffic past the other tenants as shoppers go from one to the other, comparing prices and selection. This does not happen with a grocery store anchor, as shoppers leave for home immediately after collecting their groceries. The shoppers at the department store at the other end of the mall have no compelling reason to walk past the other stores. If your business is dependent on enticing customers walking by your storefront, it might be a critical mistake to save $7,500 and lose unknown potential customers. It is worth the effort to take careful traffic counts during different times of the day to determine which location has the most walk-by customers. An entrepreneur who gives up $50,000 in sales to save $7,500 in rent will be kicking herself 365 days a year.

Super regional, regional, and most community shopping centers have **merchant associations**. The dues collected from tenants by these associations are used to advertise and to pay for entertainment events designed to attract customers. Special attractions such as Christmas decorations, antique automobile shows, or circus clowns are usually arranged by merchant associations.

Stand-Alone Stores Stores that depend on drive-by traffic are often **stand-alone stores**. They must have ample parking, good signing, and effective lighting if they are to be successful. Stand-alone stores may be located adjacent to large malls, or on the streets leading to the malls, to take advantage of the traffic flow. Since they are located away from shopping areas, the business owners pay less rent or might even own the buildings. Restaurants and automobile dealerships are examples of businesses that do well in stand-alone store space.

Industrial Businesses

Manufacturers and wholesalers also recognize the importance of location, but for different reasons. It is important that these businesses efficiently address logistical, transportation, and communication needs. A sizable part of the operating expense of an industrial company is shipping costs, both for material received and for products shipped. A manufacturer or wholesaler must deliver products in a timely manner and will therefore want to locate close to transportation facilities and, if possible, to customers. In addition, this kind of business often hires a sales force. Traveling to make sales calls is both time-consuming and expensive, so a geographically centralized location is more efficient.

Industrial Parks Good space at a reasonable rent and access to transportation couriers are two advantages offered by industrial parks. The cost is often partially subsidized by city, county, or state agencies in order to attract industrial businesses that create jobs and expand the community's tax base. Industrial parks offer large spaces that are ideal for manufacturers and bulk wholesalers.

Incubators In recent years there have been a growing number of subsidized business rental spaces called **incubators**. Incubators make it possible for new small businesses to share space and certain operating expenses, such

The Global ENTREPRENEUR

Some entrepreneurs are truly globally located. Greg Myers, an Atlanta entrepreneur, spends 80 percent of his time traveling the world and considers his office as wherever he happens to be at any time. Greg often rents temporary office space at airports around the world. Many large airports rent office space on an hourly or daily basis to international business travelers. Entrepreneurs can meet with clients and hold conferences at a convenient location, which saves considerable time traveling to and from airports. Greg believes this is a great idea: "I can meet with a client in Japan in the morning and another client in Australia in the afternoon."

Think Critically

1. Discuss with your classmates the advantages and disadvantages of a lifestyle like Greg's. Does it appeal to you?
2. Why is it important to meet face to face with customers rather than conduct business via conference calls or video transmissions?

as rent, utilities, property taxes, office equipment, and salaries for some supporting staff, such as a receptionist. The businesses may be located on different floors of a large building or in adjacent smaller buildings. Ideally, similar business start-ups are grouped together, such as technology businesses or small manufacturers, in order to share ideas as well as equipment and space.

An incubator manager assists the small businesses with certain kinds of tasks—helping to find trade shows for tenants to exhibit their products, for example, or putting them in touch with outside experts. The manager's salary is paid by the supporting agency.

Incubators are usually subsidized by state and local business development agencies and sometimes have access to federal programs. Often they are located near state universities and receive their support from educational institutions. The arrangements are not long term. Many have a time limit of three years, after which the new business must leave the incubator and find a permanent space. It is the hope of the supporting agency that by the end of the allotted time the business has fully developed into a successful enterprise with a sizable employee base, thus contributing back to the community.

The entrepreneur who needs only a small amount of space for technological development or light manufacturing should find out whether there are incubators in the community with available space.

Professional Office Space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Many entrepreneurs—real estate agents, accountants, business consultants, and architects, among others—need a professional office to meet with and sell to their clients. It is important that their offices present a professional image and be conveniently located. Many types of offices are available, from small suites in standalone buildings to penthouses at the tops of skyscrapers. The spaces are leased, and expenses vary depending on location, size, and what services the landlord offers. Rental costs are based on cost per square foot, as for retail space.

Various arrangements are available—some landlords offer furniture and equipment, and others lease just the empty space. Office suites that include a waiting room and a receptionist area are often needed to serve clients professionally. Some office complexes also rent out space, which allows tenants to share common expenses such as copying machines, a receptionist, and rest rooms. This arrangement is similar to that of an incubator, but is not normally subsidized by development agencies.

Home-Based Businesses

There has been a tremendous growth in home-based businesses over the past decade, and for some very good reasons.

- Doing business from the home is an excellent way to run a business on a limited budget. Rent, utility costs, and maintenance fees are avoided, so there is more money to purchase income-producing inventory and to advertise.
- Home-based business owners are not subject to the restrictions and obligations imposed by lease agreements.
- The owner can be at the business site around the clock.

A home-based business is excellent for the part-time entrepreneur. Many businesses start out in the owner's home, on a part-time basis, until demand is established. Then the entrepreneur can afford to move to a larger site.

You may recall the story of Flora Ramirez in Chapter 1. Flora successfully turned a part-time jewelry business into a full-time career. She started a home-based business selling handmade jewelry to retailers. She worked in her basement to fill the orders, then took the finished products to a shipping office. Once a steady demand for her merchandise had been established, she hired four people (including her husband) and moved to a nearby industrial park, where she had more working space and better access to transportation couriers.

Anyone with the desire and a good idea can operate a home-based business. Many services, such as babysitting, house and office cleaning, and lawn maintenance, can be coordinated and managed from a home office. All that is needed is a telephone to contact customers, a personal computer, and a fax line. It is also possible to sell goods via the Internet or direct mail. These goods can be offered through magazine advertisements, catalogs, or a web site. When an order is received, the product can be packaged and taken to the post office or picked up by a courier service.

There are some disadvantages to operating a home-based business. Space limitations are often a drawback. It may also be difficult to keep the business separate from family activities. The result can be constant interruptions. Also, many entrepreneurs find themselves feeling isolated from the business community. They miss the social interaction and information exchange with business colleagues. Many owners learn to treat their home business as if it were located downtown, by dressing in suitable attire, arranging lunch appointments, and getting out of the office regularly to visit customers, attend meetings, and spend time with colleagues.

DIGITAL VISION

FUN FACTS

There are over 18 million home-based businesses of all types and sizes operating in the U.S. The Census Bureau estimates that home-based businesses are increasing at the rate of 2.7 percent per year.

LEASE ARRANGEMENTS

Unless they work from home, business owners either enter into commercial lease agreements or buy commercial property. Lease agreements for commercial property are usually long and complex contracts that should not be viewed lightly. If inexperienced, the **lessee** (the tenant) should hire an attorney to carefully review the fine print. A shopping center lease may be 30 pages long and tie the lessee to a very tight contractual agreement. It is a contract that is in effect for the stated duration of the agreement whether the space is being occupied by the tenant or not. Rent payments do not stop just because the tenant wishes to stop doing business. Too often businesses close with time still left on the rental contract, and the owner must continue to pay rent for a nonexistent business. Lease contracts are like bank notes—they are for a stated amount of a guaranteed total divided by the number of months. The typical lease is written to protect the **lessor**, or landlord, from tenants vacating the property before the end of the lease.

Commercial leases are written in terms of a stated base rent per square foot of leased space. The rent cost is declared on an annual basis by multiplying the number of square feet by the stated per-square-foot charge. For instance, 2,000 square feet at $15 per square foot equals an annual rent of $30,000. The annual rent is divided by 12 to arrive at a monthly rental fee, in this case $2,500 per month. These are only the basic terms. The full terms of the lease may include anything from the amount of property and liability insurance the tenant has to carry to what type of business the tenant can operate and during what hours.

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Retail leases often include a **percentage rent clause**, which requires that the tenant pay additional rent if and when revenues exceed a certain dollar amount. The landlord is in effect receiving a reward for offering the tenant a convenient location. Figure 8-4 illustrates a cover sheet for a retail lease that includes a percentage rent clause. The business owner has agreed to pay 6 percent of gross sales if that figure is higher than the guaranteed base rent of $1,200 per month or $14,400 per year. The percentage rent kicks in when annual sales exceed $240,000 ($20,000 per month). If the merchant does a great job, the shopping center brings in a lot of traffic, and sales reach $300,000, the annual rent will be $14,400 plus 6 percent of the $60,000 overage, or $3,600, for a total rent of $18,000 per year.

FIGURE 8-4 *Cover Sheet, Retail Lease Agreement*

This lease, entered into the ______ day of ______________, 20___, between the Landlord and the Tenant hereafter named.

ARTICLE 1. Definitions and Certain Basic Principles

a. "Landlord" Smith Development Co. .

b. Landlord's address 120 Main Street .
Springfield, IL 22573 .

c. "Tenant" Mr. John Doe DBA Card Town .

d. Tenant's mailing address 32 Washington Ave. .
Springfield, IL 22513 .

e. Tenant's trade name Card Town .

f. Tenant's address in Shopping Center A-8 .

g. Demised Premises approximately 1500 square feet in Building A (computed from measurements to the exterior of outside walls of the building and to the center of interior walls) having approximate dimensions of 30 feet x 50 feet, such premises being shown and outlined on the plan attached hereto as Exhibit A and being part of the Shopping Center situated upon the property described in Exhibit B attached hereto. "Shopping Center" shall refer to the property described in Exhibit B, together with such additions and other changes as Landlord may from time to time designate as included within the Shopping Center.

h. Lease term: Commencing on the "Commencement Date" as hereinafter defined and ending thirty-six (36) months thereafter except in the event the Commencement Date is a date other than the first day of a calendar month, said term shall extend for said number of days in addition to the remainder of the calendar month following the Commencement Date.

i. "Estimated Completion Date" day of October 15, 20XX .

j. Minimum Guaranteed Rental $ 1,200.00 per month, payable in advance.

k. Percentage Rental 6 % of gross sales in excess of $ 20,000.00 per month during the calendar year, payable on or before the 10th day of each following month subject to Article IV, Section 3 below.

l. Initial Common Area Maintenance charge per month $ 92.08 .

m. Initial Insurance Escrow Payment per month $ 40.42 .

n. Initial Tax Escrow Payment per month $ 82.50 .

o. Security Deposit $ 2,998.00 refundable upon expiration of term less any damages for unusual wear and tear or charges necessary to restore the Damaged Premises to satisfactory condition.

p. Permitted use Card and gift store – retail sale of cards and gifts .

The sum of

Minimum Guaranteed Rental as set for in Article 1, Section 1.1j and 1,200.00

Initial Common Area Maintenance charge, as set forth in Article 1, Section 1.1l and 92.08

Initial Insurance Escrow Payment as set forth in Article 1, Section 1.1m 40.42

Initial Tax Escrow Payment as set forth in Article 1, Section 1.1n 82.50

Initial Base Sales Tax Payment as set forth in Article 1, Section 1.3 . . . . .84.00

MONTHLY PAYMENT TOTAL 1,499.00

1.3 In addition to its obligation to pay the Monthly Payment total, adjusted from time to time as provided herein, Tenant shall pay simultaneously herewith any sales tax, tax on rentals, and any other charges, taxes, and/or impositions now in existence or hereafter imposed by any governmental authority based upon the privilege of renting the Demised Premises or upon the amount of rent collected thereof. All payments provided for herein shall be in lawful (legal tender for public or private debt) money for the United States of America.

Ethics for ENTREPRENEURS

Inexperienced entrepreneurs often enter leasing agreements without a complete understanding of all the clauses in the lease contract. The excitement and enthusiasm of opening their first business keeps them from asking pertinent questions and doing careful research.

Leasing agents can find themselves at a lease signing asking, "Have you carefully read the lease, and do you have any questions?" The excited entrepreneur might answer, "It looks like a bunch of legal mumbo jumbo to me, but I'm sure it's what we discussed and the rent is what we agreed on. I'm ready to sign."

Think Critically

1. Does the leasing agent have an obligation to suggest postponing the signing until the entrepreneur has a chance to consult with an attorney or an experienced entrepreneur?
2. What articles in a lease might be the most difficult to understand and require further clarification?

A lease agreement may include other charges besides rent.

- **Common Area Maintenance (CAM)** Often included in retail and industrial leases. Maintenance might include anything from the cost of lighting the parking lot to having the parking spaces striped. The charge reimburses the landlord for keeping up the property and is determined by the percentage of total leased space the tenant occupies.
- **HVAC Charges** These charges, for heating and air conditioning the common property of the mall or office complex, are also determined by the percentage of total leasable space in the complex occupied by the tenant.
- **Tax Escrow Payment** The tenant agrees to pay the proportional amount of real estate property tax assessed on the complex.
- **Insurance Escrow** The tenant agrees to pay a portion of the liability insurance to protect against injuries that might occur to anyone on the common property.
- **Merchant Association Fee** Retail tenants often pay a monthly fee that might be combined with the monthly rent.

As you can see, the extra charges on a lease can add up to a substantial percentage of the total lease payment. Each situation is different. Entrepreneurs must make sure the agreements they are entering are exactly what they perceive them to be.

Leasing is a bargaining confrontation between the lessor and the lessee. Terms are normally negotiable depending on supply and demand and the desired tenant mix. If the landlord is seeking the type of business the entrepreneur represents, there may be considerable room to negotiate the lease on more favorable terms. This might include requesting that the landlord be responsible for all interior finishing work, or leasehold improvements, to the property. In all cases it never hurts to try to negotiate.

The following interview, with a former retailer who now acts as a leasing agent for community shopping centers, will give you some insight into commercial real estate.

What are the main determinants used in site selection of a shopping center?

The main considerations are competition and land costs, which include the cost to develop the land. The objective is to locate as close to the population area as possible. You do not want a location where a competing shopping center could be built between yours and the population area, thereby cutting you off from your market. The cost of the land is important, but we are not interested if there are problems such as no utilities or other complications that will drive up the building cost. We use market research to gather demographic information and try to find out if any anchor store tenants would like to locate in the area. We share the demographic information with all potential tenants.

How are rent charges determined?

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Rent charges are determined by the total cost of the site, the con-struction costs, and the cost of financing. The developer needs to show the bank a projected income statement showing that he can pay loans back based on projected rental fees. The final rent is determined in consideration of recovering costs, rent surveys of area shopping centers, and a desired rate of return on the investment. In the end, of course, it's decided by supply and demand. The anchor tenants are major determinants of rents, since they will contribute greatly to the demand for the space. Excess competition will drive the price down. Keep in mind, however, the shopping cen-ter developer has made a financing contract with the lender that he will receive X dollars per square foot of space, and anything too far removed from this figure will raise the lender's eyebrows. Regardless of market supply and demand, there is a point in negotiations at which the developer is better off carrying a vacancy than renting at reduced rates for an extended period of time.

How do you find tenants, and what do you look for?

We want tenants that complement the shopping center. We do not want to put an auto supply store in an exclusive specialty store center. The great majority of my time is spent canvassing existing merchants in the general area to alert them to our project. We prefer established businesses to new business owners. An established owner can show us a track record and we know what to expect. We really like established businesses that advertise a lot,

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because they contribute to a more vibrant shopping center. We screen new business owners closely. We request financial information and detailed plans for the proposed operation. We like to see a source of outside income in the event initial plans do not work. If the tenant has absolutely no experience, we might attempt to direct him to a franchise. If there is limited capital and little experience, we will back away from leasing to that individual. New businesses usually call us in response to a sign on the property or an announcement of our project in the newspaper.

The landlord is sometimes considered an adversary of the tenant, rather than an ally. Having been on both sides, would you comment?

The landlord is a businessperson just as the tenant is, with the same objective—to make a profit. I have found the industry to be very ethical. The developer is concerned with the tenant's success, as it ultimately determines the landlord's future success. Landlords are not villains in black hats. They are legitimate businesspeople with fair objectives. Although commercial real estate is not as strictly regulated as residential real estate, it is for the most part a very professionally run industry. However, in commercial real estate I would recommend "Caveat emptor"—let the buyer beware—as a guideline for the inexperienced entrepreneur.

BUY A BUSINESS LOCATION

The alternative to leasing is buying commercial property. Rarely is this a good choice for a new business start-up. However, once the business is established and proven, it can be a very profitable step. Successful stand-alone operations in particular should consider owning the property from which they operate. Needless to say, lease concerns become a thing of the past. There will be no landlord to raise the rent or make demands. Owning can also be a very good investment. Commercial property can escalate in value just as residential property does. The entrepreneur can achieve on two fronts: a business that makes a profit residing in a facility that appreciates in value.

The down payment on commercial property may be higher than that for a home. Lenders do not normally offer mortgages of the same duration as residential mortgages. Lenders seek shorter paybacks for commercial ventures, which are considered riskier. Like rent payments, mortgage interest is tax deductible.

EVALUATE THE FACILITIES

Choosing the facility for a new business is an important decision for business owners. Once the best location has been found, the owner must determine whether the facility is suitable for the intended business operation. It must be large enough, and it must be structurally sound. Many leases assign responsibility for all property maintenance to the lessee; if there is a leak in the roof or the plumbing or air conditioning fails, the tenant has to pay all repair costs. It is imperative that the prospective tenant carefully examine the property for structural soundness before signing the lease.

The chosen site must fit the image of the intended business. Selling fine, expensive jewelry requires a different image than selling tires does. People shopping for a $5,000 diamond ring will not shop in a run-down section of town. On the other hand, for most people, the price of a tire is more important than where the tire store is located. If you are selling to a specific market, the facility and its surroundings must appeal to that market.

Different businesses have different environmental requirements. For example, the aspiring restaurateur should consider the following:

1. Restaurants should not be in areas that are noisy, have unpleasant odors, or are frequented by vagrants.
2. The type of neighborhood will influence whether customers come in family groups, as couples, or singly.
3. Restaurants located in industrial areas will be dependent on surrounding businesses and their employees' lunch arrangements.
4. Restaurants should not be located near funeral homes or cemeteries.
5. Restaurants in residential areas rely mostly on evening trade.
6. Schools or churches are not particularly desirable as neighbors to a restaurant. They may cause congestion, and they can affect a restaurant's right to sell alcoholic beverages.
7. There must be good lighting and ample parking for customers.

The prospective business owner must fully research the location and facility requirements of the intended product or service.

Chapter Review

Ship in a BOTTLE

Setting Up Operations

After Fred and Jeanie decided against a retail store, the location decision for Ship in a Bottle came down to two options: either lease exhibit and office space at the Merchandise Mart in downtown Atlanta, or set up operations in the Johnsons' home.

Fred spent a day visiting with the Merchandise Mart leasing agent, Henry Richmond. Henry showed Fred a number of available spaces in various sections—the general gift floors, the home decor floors, and the patio and garden area. A 400-square-foot space in the gift area drew Fred's interest. The leasing cost of $2,500 per month was something of a shock, but Fred knew it would be expensive based on his experience as a temporary exhibitor, which cost that much for just five days. Leasing a permanent showroom would replace the cost of four temporary rentals per year, or $10,000. Deducting the $10,000 from the one-year total lease of $30,000 meant the added cost of permanent space would be $20,000 per year.

Fred knew that selling from a permanent showroom during the shows would greatly increase his exposure and sales. In addition, it would provide office space for Fred and a showroom in which to meet with customers when there were no shows. The idea of a deluxe showplace, a nice office, and some extra prestige was certainly appealing.

However, the benefits of working from home were equally attractive—low overhead, no lease obligation, a flexible schedule, and the casual atmosphere of home. Certain decisions and expenses were involved, however. An up-to-date computer system, including a scanner and a printer, was a must. One room, probably the spare bedroom, would have to be changed to an office. He would need to arrange for voice mail service, a toll-free 800 number for customers, and office furniture, including file cabinets and a credenza. In addition, where would he store his inventory? The garage would not work, as the ships in bottles were somewhat heat sensitive. So it would have to be the basement, which he would have to finish—another expense. All told, Fred calculated the total cost of setting up in his house would be approximately $10,000.

Fred weighed this $10,000 against a lease that would cost an added $20,000 per year. Even recognizing that sales would initially be greater from the leased space, it was not a hard decision. The fact that the business was new and still a part-time operation was the determining factor. Tax savings were another consideration—Fred could deduct 15 percent of his mortgage interest and utilities costs as legitimate business expenses as long as the business was in a separate room and the basement was used primarily for inventory storage.

The day might come when Ship in a Bottle had a fancy full-time showroom, but for now Fred would work from his home and enjoy the benefits of free rent *and* a tax deduction.

Think Critically

1. If you were in Fred's situation, would you prefer to work from your home office, or from a nicely decorated showroom downtown? Defend your choice.
2. Sketch an office layout for Fred. Indicate the various pieces of equipment he would need to carry on his business.

Summary

Successful entrepreneurs know the importance of choosing the right location. Being in the right place at the right time is an important ingredient of success. Our society has become accustomed to accessibility and convenience, and businesses should be located with that in mind.

Entrepreneurs must classify their products or services in terms of degree of convenience to the consumer. They can then determine what type of location should be chosen to successfully sell the products. This choice will depend on the product, the community, and the amount of money available to operate the business.

Entrepreneurs who sell or manufacture industrial goods might locate in an industrial park. Some small industrial and technological businesses might choose to locate in partially subsidized spaces called incubators.

Many entrepreneurs operate small businesses from their homes, and some then move to a larger space after demand has been established. A home-based business is an excellent starting place for the part-time entrepreneur.

It is important that inexperienced entrepreneurs learn the intricacies of commercial leases. Many clauses in leases address the obligations of the tenant and can affect the amount paid to the landlord. It is generally advisable to seek the assistance of an attorney before signing a lease.

A Case in POINT

Stacy Roper had wanted to open a ladies' fashion boutique on posh Park Avenue since moving to the neighborhood five years ago. The tree-lined shopping area comprised four blocks of unusual boutiques, jewelry shops, craft stores, and European-style restaurants. The shopping area was so busy and successful that openings for new stores were rare. When a vacancy did occur, the lessor would simply contact the next person on a long tenant waiting list.

When Stacy learned that the old movie theater on the busiest block was to be converted into a three-story complex of small stores, she contacted the developer. The developer's plan provided for 18 store spaces of approximately 800 square feet each. The developer was hoping for a balanced tenant mix of specialty retail stores and food services. The idea was to have a restaurant, a gift shop, an apparel store, and three other stores on each level. This would ensure a good traffic flow throughout the complex. Stacy leased the ground-floor apparel space, just inside the entrance. She had carefully scrutinized the shops across the street, and they all seemed to be very successful. Stacy was confident she had made a good decision.

During the nine months that it took to remodel the theater, Stacy planned an exciting presentation. She bought her inventory from the leading apparel designers and consulted with top professionals on store layout. The finished store was truly eye-catching. It had the latest in display pieces and mannequins, elegant color-coordinated decor, and a sophisticated sales checkout system.

The Colony Theater Shopping Galleria opened with great fanfare. Of the 18 spaces, 15 opened on time, and the initial reaction was enthusiastic. Stacy was very pleased with the first month's receipts, but during the second month the pace was inconsistent, traffic seemed to thin, and sales leveled off. Some days were so busy it was hard to keep up, and others were so slow there might as well have been a barrier in front of the building. Business across the street continued at its usual hectic pace.

continued

Chapter Review

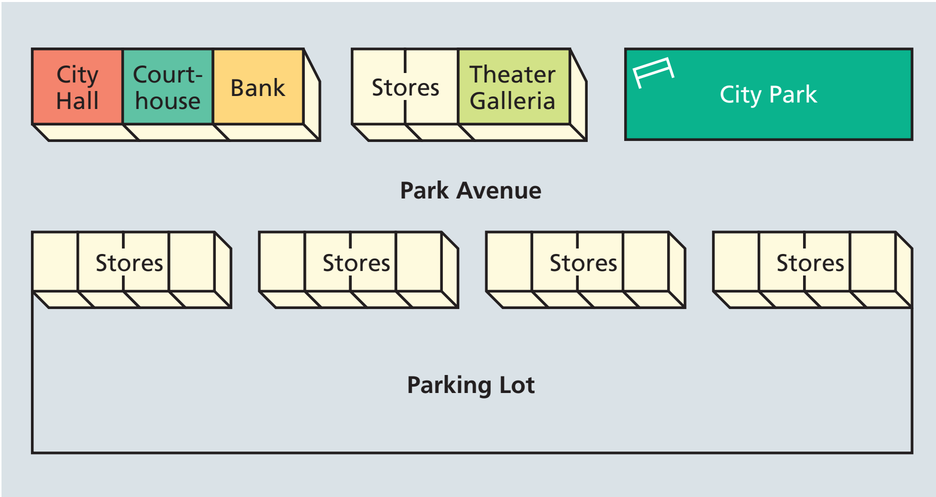
A year later Stacy contemplated closing. Six of the original merchants had already moved out. Four had been replaced, but the new tenants were not of the same stature as the original stores. Meanwhile, businesses on the other side of Park Avenue continued to prosper.

Think Critically

1. Examine Figure 8-5. Can you identify some of the reasons why the Colony Theater Shopping Galleria had difficulty attracting shoppers?
2. Based on your knowledge of the importance of convenience, what could be done to help the stores in the Galleria?
3. Do you think Stacy should close her store?

FIGURE 8-5

Colony Theater Shopping Galleria



Vocabulary Builder

Write a brief definition of each word or phrase.

1. anchor store
2. big box store center
3. community shopping center
4. convenience goods
5. discount outlet center
6. incubator
7. lessee
8. lessor
9. merchant association
10. neighborhood shopping center
11. percentage rent clause
12. profit margin
13. regional shopping center
14. shopping goods
15. specialty goods
16. stand-alone store
17. super regional shopping center

Review the Concepts

18. What role does convenience play in choosing a business location?
19. What are the differences between convenience goods, shopping goods, and specialty goods?
20. How do neighborhood, community, regional, and super regional shopping centers differ?
21. What is the purpose of a merchant association?
22. List the advantages of a home-based business.
23. What is a percentage rent clause?
24. When is buying a business location a good idea?
25. What considerations must be taken into account when evaluating a facility?

Critical Thinking

26. Explain what is meant by the convenience theory.
27. List location considerations in starting a retail business.
28. List location considerations in starting an industrial business.
29. How can the choice of location be a competitive advantage?
30. Are there any drawbacks to operating a home-based business?
31. Why is a commercial lease considered a contract?
32. Describe three clauses often found in commercial leases that add to the overall cost of the rental agreement.

Project

Build Your Business Plan

Choose a location for your business, applying what you have learned.

If your business sells retail, classify your product or service as convenience, shopping, or specialty goods. Visit shopping areas in your community where you would expect to find similar products. Note how successful these areas seem to be, based on the number of shoppers and how well the individual businesses appear to be doing. Call leasing agents and inquire about costs and other leasing considerations. Request to see a sample lease.

If you are starting an industrial, wholesale, technological, or professional business, ask leasing agents for information about industrial parks, incubators, and professional office space, including terms and considerations.

If you want to start a home-based business, decide how you would use your home as a place of business.

Now make your location decision. Remember to consider the surrounding environment and the facility itself. Defend your reasons for choosing the location.

Unit 2 Case Study

Which Business?

The time was right for Jarrid Barton to explore new career opportunities. He was completing his bachelor's degree in business administration, and his job with a large West Coast computer contractor was probably going to be eliminated due to industry-wide downsizing. With a degree, experience as a purchasing agent, and the knowledge that he wanted to be his own boss, Jarrid was ready to identify the employment options available to him.

Jarrid decided to start by creating a list of jobs he felt would interest him. He first evaluated his past work experiences to determine which responsibilities and tasks he enjoyed most. Working with people, accepting greater responsibility, and initiating new projects headed the list. Personal choice criteria included a desire to serve the community, maintain professional satisfaction, and earn the respect of clients and peers. Skills that Jarrid identified included his management style, computer expertise, and ability to negotiate contractual agreements. From this information he compiled a list of industries that he found appealing:

food services
recycling
manufacturing parts, wholesale
delivery services
restaurant supply
sporting goods, retail

Jarrid's next step was to do some analysis of each industry. First he gathered relevant information from various local agencies. The Los Angeles Chamber of Commerce provided statistics concerning the economic health and growth projections of surrounding communities. The Small Business Development Center offered leads to sources of specific industry information. The LA Economic Development Agency gave him a list of industries they considered to be underrepresented in southern California. Jarrid ended up with a small library of information from over a dozen agencies. After more than a month of research, telephone calls, and personal visits, Jarrid narrowed his findings to three primary markets.

1. ***Restaurant supply*** The Los Angeles area appeared to have a need for a restaurant supply business specializing in gourmet produce. In his initial research, Jarrid found a directory of produce suppliers in the greater LA area. Much to his surprise, there were only 13 major suppliers. He also discovered that many restaurateurs were dissatisfied with the service they received from these suppliers. The deliveries arrived late in the day and the produce frequently did not look fresh.

   The restaurant supply business had possibilities. With so few potential competitors, it would be fairly easy to establish name recognition. The competitive analysis would also be greatly simplified because of the small number of competitors. The business met his personal choice criteria of providing professional satisfaction and the ability to earn respect from clients and peers.

2. ***Recycling*** Initial research revealed that small communities on the fringe areas of Los Angeles did not have adequate recycling services. There were not enough

municipal or private recycling companies to fill this growing need. Jarrid recognized several opportunities in the industry, including trash/recycling collection services and beverage container recycling. Through further research, Jarrid discovered that the California Refund Value (CRV) was 2.5 cents for containers smaller than 24 ounces and 5 cents for containers 24 ounces or larger.

The recycling business also had possibilities. Jarrid estimated he could make a living with a well-run beverage recycling center. According to the California Beverage Container Recycling and Litter Reduction Act, many containers other than aluminum were subject to CRV, including glass, plastic, and bimetal containers.

Working in the recycling business would make use of his past experience dealing with people and initiating new projects. Additionally, it met his personal choice requirement of serving the community.

3. ***Exporting manufacturing parts*** Requests and orders for manufacturing parts from Pacific Rim companies were not being filled. At the same time, there appeared to be a surplus of inventory among many smaller local parts manufacturers. When Jarrid conducted his initial research, he was amazed at the huge number of companies in California producing manufacturing parts.

   Further research did turn up a few major competitors in the LA market. They were well established, with many international clients. Jarrid knew the international manufacturing parts business would require more business sophistication than his other two choices would. It would definitely be more of a challenge. His computer expertise and ability to negotiate contractual agreements would certainly come in handy. Exporting manufacturing parts, like the other two options, had real possibility.

Jarrid was now ready for the next step. All three opportunities interested him. How would he decide which one had the most potential? As you answer the case questions, keep in mind Jarrid's work experience, personal choice criteria for a business, and job skills.

Case Questions

1. Jarrid must research potential target markets for each business. How do you suggest he proceed?
2. Jarrid has barely begun to examine the competitive environment for each business. Where should he start?
3. For each business, suggest to Jarrid the two most important "P's" he should consider and why each is important to a particular business.
4. Given what you know about Jarrid, which business would appear to offer him the greatest potential satisfaction? Explain your choice.