Section 3 Lecture

Site Selection: Choosing the Right Location

Lecturer: Steve Temmermand

Have you ever considered why certain businesses always locate near each other? For example, why do banks generally locate near other banks? Or why do certain businesses succeed while others fail in similar locations? Hi, I'm Steve Temmermand. I help organizations develop strategies on how to use geography. In this section, we will cover the decision process related to selecting the best location for a business. I've used these techniques to guide investors and governments to invest millions of dollars and create thousands of jobs, so I'm excited to share these insights with you.

The process includes answering questions about the relevance of geography, why businesses locate in certain areas, and factors to consider so you can choose the optimal location. Let's start by revisiting the question of geography's relevance. If you ask a real estate agent to list the three factors that contribute the most value to a property, they are likely to reply, "Location, location, location." In real estate appraisal, there's a concept called highest and best use. This concept provides a methodical way to determine the maximum value for a property. Location is an important part of the equation.

Here's an aerial image showing part of a neighborhood along Lake Shore Drive in Chicago. Considering the site outlined in orange, which kind of business do you suppose is the best use for this location: a flower shop or a gas station? Or are they equally well suited? Site selection is important to many different types of businesses. Whether your business is a real estate organization wanting to get the most return from a property, or a retail organization trying to place a new store outlet, or even a financial services organization trying to decide whether or not to loan money for the construction of a new store, location matters.

Let’s review some of the factors businesses must consider when choosing the right locations. Often, the first consideration is whether locating on a particular site is legally allowable. For example, you can’t sell liquor too close to a school.

Second, you need to consider whether locating on a site is physically possible. For instance, a potential location for a health care clinic might not have accessible parking spaces nearby. Third, potential sites need to be financially feasible. For example, an ATM requires investments in lighting and security.

Finally, the site needs to be maximally productive. Like the aerial image shown earlier, it makes more sense to put a gas station next to a busy thoroughfare instead of a flower shop because the location will receive a higher volume of car traffic than foot traffic, so the profit potential would be greater.

Next, let’s consider some of the factors that affect the potential success of a given business at a particular location. First, consider how near that business must be located relative to its customers. The geographic area from which a company draws the main portion of its business is called a trade area. To understand how large of a trade area a certain product might serve, you must think about the draw, or gravity, that a product has. You can use gravity models to predict and describe behaviors. For example, think about how far you would travel to purchase different items and how those distances vary. How far would you be willing to travel to buy milk, versus a new phone or a car? What about a restaurant for a quick lunch, versus a formal dinner to celebrate an occasion? This map shows where customers of a retail format live, with its approximate trade area circled. Since the trade area is fairly large, you might guess that this is not a small business, like a convenience store. It's more likely to be a high-end apparel shop or something similar, as people are traveling--as people are willing to travel several miles to go there. Retail format means the type of retail store, such as a convenience store, department store, luxury store, drug store, online e-tailer, catalog, and so on. The trade area for a convenience store will be much smaller than for a luxury store, for example.

Understanding gravity, customer behavior, and trade areas allows you to apply the location advantage to decision making. There are several different ways to conceive of trade areas. You can look at actual distance to a store (as the crow flies) using distance rings on a map. Likewise,

you can define a trade area in terms of the time it takes to travel to your location, or the distance to your location by roads.

This example shows trade areas created by drive times, based on five-, 10-, and 15-minute distances reached by car. Or, you could look at the minimum number of people needed to frequent your store format: a threshold population, or even a threshold of certain customer characteristics. For example, if you are selling children's apparel, how many households nearby have children under the age of 10?

Another factor to consider is competition. Who are your competitors, and where are they in the current market? Suppose your business is coffee shops. If you're considering opening up a new shop, who is your competition? It could be a large well-known coffee shop with locations around the globe, or it could be a small local mom-and-pop cafe. And, are you really competing for coffee, or is it the breakfast experience? Maybe you're marketing ease and convenience, or popular variations such as organic or sustainably grown coffee.

Next, how do you go to market? Where do you locate? Your format might be successful if you follow where another format goes to market. That could be a format similar to your own, or it could be different. For example, if you sell women's apparel, you might locate near another clothing store, or near a fitness center or yoga studio. Or maybe you want to think about a shadow strategy in which you locate your business within the shadow of a larger population, such as a medical center or educational institution. Or you might think about a co-location strategy. For example, you may want to place your ATMs inside of a grocery store or a hotel.

Next, you must look at the difficulty level of getting supplies and inventory into your new location. How far away are the distribution centers? What does the transportation network look like? Difficult, slow transport or distant distribution centers have the real potential to increase cost. The cost to bring your product to your customers will then have an impact on price, which is important. Costs could be driven so high that it becomes difficult to sell a competitively priced product.

Another factor is safety. There are several aspects to safety, and providing a safe working and shopping environment could have the real potential to increase cost.

One aspect of safety is product safety. If you're selling refrigerated goods that need to be maintained at a certain temperature, can you ensure that temperature as the goods travel from the manufacturer to the store?

Another aspect is location safety. What was on the site previously? Does there need to be any environmental remediation? Has there ever been water damage? Is the water safe to drink? Is the building in a flood zone?

Then there's customer safety. Will a customer be safe using an ATM, for instance? Is it well-lit? Then there's employee safety. What is the route that a restaurant employee should walk to deposit money at the end of the night? Is the parking lot safe?

As you can see, there are many factors that constitute a good location. But you must also consider local demographics. How many people live in the trade area? How many people work in the area? You can obtain this information by looking at the daytime versus night-time populations.

Next, who lives in the area? Are there lots of young families with children, or a high percentage of seniors? What is the average household income, and do local consumer buying preferences align with your offerings?

Demographics also apply when determining if a qualified workforce is available to staff your business. What is the local educational attainment level? Do potential employees have access to transportation?

Another factor to consider is the physical characteristics of a place. The transportation network comes into play again here. How will your customers travel to your location? Will they walk, drive, take a bus, or bicycle? The location needs easy access for all modes and needs to have sufficient parking. Generally, busy areas are good, but if there's too much traffic, access will be more difficult.

Visibility is important, too. Can people see your store front? And consider where you'll place your sign. Will it be visible from high-traffic areas?

Finally, there are a few more costs to consider. Capex, or capital expenditure costs, will include the cost to build out, construction and safety costs, and environmental considerations. Ongoing costs to consider include insurance, labor, taxes, various utilities, and maintenance of lighting, heating, cooling, water, and wastewater systems. These are just the costs of doing business, and they vary by location.

I hope you enjoyed this overview of the process of choosing the optimal location. Now, as you pass by businesses on your way to work or school, think about the decision process that landed them where they are.

Next, please view the video case studies later in this section. They explain how leading businesses use market planning and geography to identify new store locations. Later in this section, you'll have a chance to perform a site selection analysis yourself. We discussed how geography is relevant to appraisal, defines your trade areas, lets you execute your market strategy, and impacts your costs. As a fellow business graduate, I use geography in this way to drive success for the organizations that I support.