LEARNING OUTCOMES

After reading this chapter, you should be able to:

12.1 Describe small business distribution and explain how “efficiencies” affect channels of distribution.

12.2 Explain how the location of your business can provide a competitive advantage.

12.3 Discuss the central issues in choosing a particular site within a city.

12.4 Compare the three basic types of locations.

12.5 Explain the types of layout you can choose.

12.6 Present the circumstances under which leasing, buying, or building is an appropriate choice.

So you have a great product or service. Now where do you locate that product and how do you get that product to the right place so the consumer who is the end user can make the purchase? There are a variety of choices when it comes to the location for selling your product. We’ve all heard the statement: A critical key to the success of your business depends upon location, location, location. With today’s technology, there are some new choices as well as more traditional choices when deciding where to locate.

Think—it’s two minutes before class and you need caffeine. You run to the closest vending machine—fairly common occurrence, right? Vending machines can provide consumers access to a product 24/7 with no employee costs. Now think pizza, beer, and swimsuits? Not products we ordinarily think of finding in a vending machine. However, with today’s technology and a global market, a consumer can get pizza for $5 with choice of toppings, and you can watch the machine knead dough and bake the pie in about three minutes in Italy, and dispense beer in the Czech Republic and swimsuits in New York, Los Angeles, and Miami right from a vending machine conveniently located with consumer goods.

Other surprising items that can be accessed via vending distribution (essentially making them available 24/7) like RollaSole comfortable shoes, mini works of art in reworked cigarette machines, or 63 shades of nail polish in Paris. Japanese clothing retailer, Uniqlo offers shirts and down jackets in tall machines in U.S. airports. Sprinkles Cupcake ATM has 15 locations stocked with cupcakes and cookies—you just select a flavor and a robotic arm will immediately dispense it for you. Even crazier example? The Dallas-based tattoo parlor Ems Street Tattoo’s has vending machines that dispense a random design for just $100 (you still have to find an artist to do the actual tattoo work).

This chapter discusses how to get the product or service produced by your small business through distribution channels into locations where the end user, the consumer, can purchase and use the product.

In marketing, *distribution* has two meanings: the physical transportation of products from one place to the next, and the relationships between intermediaries who move the products—otherwise called the *channels of distribution*. There are two types of distribution channels: direct and indirect (see Figure 12.1). With a **direct channel**, products and services go directly from the producer to the consumer. Buying sweet potatoes and corn at a farmer’s market, or a pair of sandals directly from the artisan who made them, are examples of sales through a direct channel. Other examples are buying seconds and overruns from factory outlets or through catalog sales managed by the manufacturer.

An **indirect channel** is so called because products pass through various intermediaries before reaching the consumer. Small businesses that use more than one channel (such as a swimsuit producer selling to an intermediary like a retail chain and directly to consumers via catalog sales) are said to use **dual distribution**.

Intermediaries include agents, brokers, wholesalers, and retailers. **Agents** bring buyers and sellers together and facilitate the exchange. They may be called *manufacturer’s agents*, *selling agents*, or *sales representatives*.

**Brokers** represent clients who buy or sell specialized goods or seasonal products. Neither brokers nor agents take title to the goods sold.

**FIGURE 12.1**

**Channels of Distribution**

Channels of distribution are systems through which products flow from producers to consumers.

<table>
<thead>
<tr>
<th>Consumer Products</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Originators</strong> (producers of raw materials, farmers, miners, fisheries, foresters, etc.)</td>
</tr>
<tr>
<td><strong>Wholesalers</strong></td>
</tr>
<tr>
<td><strong>Manufacturers</strong></td>
</tr>
<tr>
<td><strong>Agents</strong></td>
</tr>
<tr>
<td><strong>Merchant wholesalers</strong></td>
</tr>
<tr>
<td><strong>Retailers</strong></td>
</tr>
<tr>
<td><strong>Consumers</strong></td>
</tr>
</tbody>
</table>

**Direct channel** | **Indirect channel**
Wholesalers buy products in bulk from producers and then resell them to other wholesalers or to retailers. Wholesalers take title to goods and usually take possession.

Retailers sell products to the ultimate consumer. Retailers take title and possession of the goods they distribute.

The key word for evaluating a channel of distribution is efficiency—getting products to target markets in the fastest, least expensive way possible. Did you realize that about three-fourths of the money spent on food goes to distribution?

Does adding intermediaries to the channel of distribution increase the cost of getting the product to the consumer? Or does “doing away with the middleman” always mean savings to consumers? Although the latter has become a marketing cliché, it is not always true. Adding intermediaries can decrease the price to the consumer if each intermediary increases the efficiency of the channel. You can do away with the middleman, but you can’t replace her function. Someone still has to do the job.

For example, if your business needs half a truckload of supplies every month from your main supplier 400 miles away, should you buy your own truck or have the supplies shipped via a common carrier (a trucking company that hauls products for hire)? If that were the only time you needed a truck, of course it would be cheaper to have the supplies shipped, even though it adds an intermediary to your channel of distribution. If you do away with the middleman—in this case, the trucking company—you must replace its function by buying your own truck, paying a driver, maintaining the vehicle, filing paperwork, and so on. The question here is not whether the functions of an intermediary are performed; the question is who performs them.

You need to be prepared to revise the way you get your products to consumers because the efficiency of channels can change. Currently, the fastest-growing distribution systems involve non-store marketing, including vending machines, telemarketing, and direct mail. Sometimes a break from the industry norm can create a competitive advantage for your business. When Michael Dell started the Dell computer company, he eliminated all of the usual intermediaries found in the personal computer market. Dell advertised and sold directly to consumers. This distribution strategy shot Dell into the Fortune 500.

Efficiencies in channels of distribution not only allow small businesses to offer goods more efficiently (and therefore more profitably), but also provide opportunities for starting new businesses. If you establish a firm that will increase the efficiency of an existing channel, you are providing a needed service, which is the basis for a good business.

Concept Check Question

1. How can a small business owner create competitive advantage with a channel of distribution?

Concept Module 12.2: Location for the Long Run

LO 12.2: Explain how the location of your business can provide a competitive advantage.

Selecting a location for your business is one of the most important decisions you will make as a small business owner. Although not every business depends on foot traffic for its customers, just about any business can pick a poor location for one reason or another. For example, retail businesses need to be easily accessible to their consumers. A company that produces concrete blocks for construction must be located in an area that frequently uses that type of building material, if it is to keep down transportation costs. Manufacturing businesses need to consider locating near their workers, sources of raw materials, and transportation outlets.
People do not tend to go out of their way to find a business. Although Ralph Waldo Emerson had great literary success when he wrote, “If a man can make a better mousetrap than his neighbor, though he builds his house in the woods, the world will make a beaten path to his door,” it’s best not to take his advice literally when selecting a location for your business.

This chapter will follow the building location process from the broadest decisions (selecting a state or region) to the narrowest (designing a layout of your facilities). There are four essential questions you need to ask:

1. What region of the country would be best for your business?
2. What state within that region satisfies your needs?
3. What city within that region will best suit you?
4. What specific site within that city will accommodate your business?

Don’t automatically jump to the fourth question. By beginning the site selection process broadly and then narrowing down your choices, you can choose a location that meets the needs of your target market and is near other businesses that are complementary to yours (see Figure 12.2).

To analyze a potential location for your business, you will want to consider the specific needs of your business in conjunction with your personal preferences. First, establish the criteria that

![Figure 12.2: Identification of Regional and Local Markets](image-url)
are essential to your success. Then list those that are desirable but not mandatory. Examples of criteria include the following:

- Price and availability of land and water
- Quality and quantity of labor pool
- Access to your customers
- Proximity of suppliers
- Access to transportation (air, highway, and rail)
- Location of competition
- Public attitudes toward new businesses
- Laws, regulations, and taxes
- Your personal preference regarding where to live
- Financial incentives provided (tax breaks, bond issues, and guaranteed loans)
- Quality of schools
- Quality of life (crime rate, recreation opportunities, housing, cost of living, and cultural activities)

**State Selection**

Most small business owners start and operate their businesses in the area where they currently live. Other people, however, are anxious to relocate to another part of the country (or world) to run their small businesses.

The United States is a collection of local and regional markets rather than one big market. Business conditions vary from place to place. Economic booms and recessions vary from region to region. Markets and people’s tastes vary from region to region as well, and these regional differences may influence the decision about where you should locate your business. For example, your recipe for deep-dish pizza may not set your business apart from the competition in Chicago, where that style of pizza is already very popular. By contrast, it may make your business unique in Flagstaff, Arizona, or Biloxi, Mississippi.

Every state, city, and town has an economic incentive to recruit businesses to relocate within their borders for the jobs and taxes contributed to their local economy. In exchange for commitments to relocate, businesses are offered reductions in sales taxes, enhanced tax credits for capital investment in business property (like machinery and equipment) and real property (like buildings and land), zoning and permit assistance, cash-grant incentives, low-interest loans, job training, and/or regulatory flexibility.

Where do you find information to compare and contrast the economic performance of regions, states, and cities? Several sources are available. Branding Facilities operates a website that highlights the economic development and site selection news broken down by every state (see https://businessfacilities.com/state-by-state-incentives-guide). Every year, *Inc.* magazine publishes its annual “Metro Report,” which ranks job growth, population growth, business starts, growth in personal earnings, and employment pool data. *Fortune* magazine regularly includes information on regional and state economies in its “Looking Forward.” *Business Week, Forbes, the Wall Street Journal, Entrepreneur*, and *USA Today* all regularly publish accounts of current regional and national information. The U.S. Census Bureau gathers data by geographic region every 10 years and maintains an extensive database.
Relocating (or initially locating) a business is a huge decision—for the business owner, its customers, and especially the employees. There are many possible reasons for such a move. Some places are better than others for offering proximity to vendors or customers, tax burden or other financial incentives, cost of living, quality of life, or access to workforce talent. As with most business decisions, the benefits must outweigh the costs.

In its annual ranking of the “best-performing cities” in the United States, the Milken Institute shows the Sun Belt—running from the Southeast through the Southwest regions—and especially the cities in those regions—topping its list again for 2017. Orlando, Florida; Austin, Texas; and Nashville, Tennessee, among other cities have accelerating ecosystems for small businesses.

Such a big move (literally) takes thought and preparation. Consider the following questions:

- Can you serve potential clients better in another region? If you are selling to consumers, this question is best answered via marketing research. Location can be your competitive advantage if you can create a substantial list of clients in your new city.
- Is the local business community welcoming of new entrants to the market? As noted in this chapter, states and cities offer incentives to businesses considering relocation. But can you project how well your business will fit in after the incentives expire?
- Is there a vibrant ecosystem of companies doing interesting things? Small business success begets other small business success. A business climate is fertile ground for innovation. A great business city has a healthy mix of established traditional businesses to support and partner with new disruptors.
- Is there a talent base motivated to stay? Your growing business needs talent to run and grow. College towns are perfect for young companies in need of the skills young employees bring.
- Can you get there from here? A location with access to transportation into and out of the city is an important key for long-term viability. This applies both for people and for goods.

Location is one of the most significant competitive advantages you can build into your small business. Choose wisely.

Sources:

Concept Check Questions

1. Why should the small business owner consider the demographics of an area when choosing a location for opening a new business? Name some sources of demographic information that are valuable tools to use in this evaluation.
2. When choosing a location for a new business, what are the most important criteria for the entrepreneur to consider? Explain the connection between type of business and location.
3. Why would a small business flourish in one area of the United States but fail in another region?
4. How can your business location affect customers’ image and perception of your business?

Concept Module 12.3: Site Selection

- LO 12.3: Discuss the central issues in choosing a particular site within a city.

Whereas the total makeup of the U.S. marketplace is diverse and complex, neighborhoods tend to be just the opposite. People are generally more comfortable in areas where people
like themselves live. Thus the cliché “opposites attract” doesn’t usually hold true for neighborhoods. The reasons for this demographic fact can be a matter of practicality as much as preference. People of similar income can afford similarly priced houses, which are generally built in the same area. Neighborhoods also tend to contain clusters of similar age groups, religious groups, families, and cultural groups. These factors distinguish one neighborhood from another. They are therefore important to consider in locating your business.

To distinguish different neighborhood types, Nielsen Claritas has three systems to provide detailed demographic and segmentation information: PRIZM, P$YCLE, and Connexions. These systems provide information on consumer behavior including household affluence, likes, dislikes, lifestyles, purchase preferences, and media preferences based upon 66 segments. Some examples of the segments are Big Fish, Small Pond (older, upper-class college-educated professionals without kids); Back Country Folks (over 55, rural lifestyle, median income $33,000); and Park Bench Senior (retired singles with low-key sedentary lifestyles). Want to see what these systems have to say about your ZIP code? Go to www.mybestsegments.com and find out.¹

Site Questions

Choosing the correct site involves answering many questions about each location being considered. You must find the right kind of site for your business. It must be accessible to your customers and vendors, and it must satisfy all legal requirements and economic needs of your business.

Type of Site

- Is the site located near target markets?
- Is the type of building appropriate for your business?
- What is the site’s age and condition?
- How large is the trade area?
- Will adjacent businesses complement or compete with your firm?

Accessibility

- How are road patterns and conditions?
- Do any natural or artificial barriers obstruct access to the site?
- Does the site have good visibility?
- Is traffic flow too high or too low?
- Is the entrance or exit to parking convenient?
- Is parking adequate?
- Is the site accessible by mass transit?
- Can vendor deliveries be made easily?

Legal Considerations

- Is the zoning compatible with your firm?
- Does the building meet building codes?
- Will your external signs be compatible with zoning ordinances?
- Can you get any special licenses you will need (such as a liquor license)?
Economic Factors

- How much are occupancy costs?
- Are the amenities worth the cost?
- How much will leasehold improvements and other one-time costs be?

Traffic Flow

The number of cars and pedestrians passing a site strongly affects its potential for retail sales. If you are a retailer, you need to determine whether the type and amount of traffic are sufficient for your business. Fast-food franchises have precise specifications for number counts of vehicles travelling at specified speeds in each direction as part of their location analysis. State highway departments can usually provide statistics on traffic counts for most public roads.

Type of traffic is important, because you don’t receive any particular benefit if the people passing your business are not likely to stop. For example, suppose you are comparing two locations for your upscale jewelry store—one in a central business district and the other in a small shopping center with other specialty stores in an exclusive neighborhood. Total volume of traffic by the central business district location will be higher, but you will enjoy more of the right type of traffic for your store at the small shopping center.

Other businesses in the area will affect the type of traffic. This explains why you often see automobile dealerships clustered together. The synergy created from several similar businesses located together can be very beneficial, with customers coming to a specific area to “shop around” before buying. Your chances of attracting customers in the market for an auto will be much greater in a location with complementary competition than if your location is isolated.

Some key questions to ask as you choose your location are

- Is your business going to be formal or laid back and casual? Your location should be consistent with your specific style and image.
- Are you on the correct side of the street for the flow of traffic? How many lanes of traffic must be crossed in order to reach your entrance?
- Do you have sufficient parking all times of the day? Is it easy to get to?
- Do you out-position your closest competitors in this area?
- What does the nearby competition look like? Sometimes having competitors nearby is good when customers like to comparison shop.
- For retail businesses, foot traffic is very important so you don’t want to be tucked away.
- Is there an anchor store near you? Is your product differentiated from that product?
- Many older buildings don’t have the necessary infrastructure to support the high-tech needs (like adequate electrical, air conditioning, and telecommunications services) of modern businesses.2

Concept Check Question

1. Explain the importance of knowing the legal requirements of an area before attempting to open a small business.
Concept Module 12.4: Location Types

- LO 12.4: Compare the three basic types of locations.

Commercial retail locations are available in many different forms. Think about businesses in your town. Service and retail businesses have several choices for types of locations: central business districts, shopping centers, and stand-alone locations.

Central Business Districts

The central business district (CBD) is usually the oldest section of a city. Although urban blight caused many businesses to desert CBDs in favor of the suburbs, many other CBDs have undergone a gentrification process, meaning that old buildings have been restored, or razed and replaced with new offices, retail shops, or housing. This planning and development, such as Denver’s Larimer Square and Chicago’s Water Tower Place, have created some of the best and most expensive locations for many types of retailers.

The advantages of locating in a CBD are that your customers generally will have access to public transportation; to a variety of images, prices, and services; and to many other businesses. The disadvantages can include parking availability, which is usually very tight and expensive; traffic congestion; possibly a high crime rate; older buildings; and sharp disparities between neighborhoods, in which one block can be upscale while the next is run-down.

Shopping Centers

Although concentrated shopping areas have existed for centuries, from the 1950s to 2005, the United States witnessed the “malling of America” with about 1,500 malls built. They have been on a long downward slide since 2005. Malls located in heavily populated, affluent areas still thrive, but many struggle or close. Those malls that maintain the right combination of attributes to succeed remain solid locations for small businesses taking advantage of the foot traffic that malls generate.

Shopping centers and malls are centrally owned or managed, have balanced store offerings, and have their own parking facilities. Anchor stores are major department stores that draw people into the shopping center.

Over the last several decades, shoppers have come to demand the convenience of shopping centers. People living in the suburbs want to be able to drive to a location where they can park easily and find a wide variety of goods and services. Shopping centers have also gone through an evolutionary process, tending toward larger centers offering more variety, wider selections, and more entertainment. Have megamalls like the West Edmonton Mall or the Mall of America gone too far in this evolutionary process? Have they reached the point of being “too big”? Ultimately, the consumer market will decide.

Advantages shopping centers can offer to your business, compared with a CBD, include heavy traffic drawn by the wide variety of products available, closeness to population centers, cooperative planning and cost sharing, access to highways, ample parking, a lower crime rate, and a clean, neat environment.

A disadvantage of locating within a shopping center is the inflexibility of your store hours. If the center is open from 9 a.m. to 10 p.m., you can’t open your store from noon until midnight. Your rent is often higher than in an outside location. The central management of the shopping center may restrict the merchandise you sell. Your operations are limited, membership is required in the center’s merchant organization, and you face the possibility of having too much competition. Smaller stores may be dominated by anchor stores.

Shopping centers will continue to evolve rapidly. Aging centers are being renovated. As shoppers become more dependent on malls and shopping centers to supply their needs, more

anchor stores

Large retail stores that attract people to shop at malls.
service-oriented businesses, such as banks, health clinics, day care centers, and insurance offices, will be located in malls.

**Stand-Alone Locations**

Drawing in and keeping customers are difficult tasks, especially if you choose a freestanding, or stand-alone, location. With a freestanding location, your business must be the customers’ destination point. Therefore, your competitive advantage must be made very clear to them. You must have unique merchandise, large selections, low prices, exceptional service, or special promotions to get them in.

Advantages of stand-alone locations include the freedom to set your own hours and operate the way you choose. You may have no direct competition nearby. More parking may be available, and rent may be lower than what you would pay at a shopping center.

Disadvantages of having your business in a stand-alone location include the loss of synergy that can be created when the right combination of businesses is located together. You have to increase your advertising and promotional spending to get customers in your door. You can’t share operating costs with other businesses. You may have to build rather than rent.

If the goods or services that you offer are destination-oriented products (like health clubs, convenience stores, or wholesale clubs), a freestanding location may be the right choice for your business.

**Service Locations**

With some exceptions, the location decision for service businesses is just as important as it is for businesses selling tangible products. Services tend to be hard to differentiate, that is, to show how one is different from another. People will not go out of their way to visit a specific service business if they think there is very little difference between services, so car washes, video rental stores, dry cleaners, and similar services must be very careful about the convenience of their locations. With service businesses that visit the customer (like plumbers, landscapers, and carpet cleaners), location is not critical.

**Incubators**

In the early 1980s, government agencies, universities, and private business groups began creating business incubators to help new businesses get started in their area. Today, several hundred incubators operate in the United States, and their number is growing. Approximately 80 percent of business incubator graduates remain in business and they grow 22 times faster than start-ups not using an incubator, according to the International Business Innovation Association (InBIA). Incubators offer entrepreneurs below-market rent prices, along with services and equipment that are difficult for start-up businesses to provide on their own. They encourage entrepreneurship, which contributes to economic development.

Businesses are not allowed to take advantage of these benefits indefinitely, and they must “graduate” to outside locations as they grow. Choosing an incubator as your starting location can help you through the first months when your new business is at its most fragile. As noted earlier, a major advantage of incubators is that they charge lower-than-market rent.

Incubators have huge economic impact on communities and small business owners. The incubator that your author has been associated with for two decades in Grand Junction, Colorado, formed in 1987 when the area suffered from an energy-related economic bust. With 35,000 square feet, the Business Incubator Center (BIC) hosts 50 to 65 tenants at any given time and works with over 1,000 clients each year. Since its inception, BIC has
WHAT WOULD YOU DO?

THAT’S THE SPOT

Jodi has a problem. She has decided to go into business for herself selling used books, DVDs, CDs, and vinyl. She lives in a community of about 200,000 in the northeastern part of the United States. No other stores in the area specialize in the used products she will sell. Her community has a large regional shopping center with four anchor stores. Two sites the size she needs (approximately 2,000 square feet) are currently vacant in the mall.

The central business district is thriving, primarily with small boutique-type stores. The atmosphere is pleasant, with many trees, flower beds, and artistic sculptures lining the streets. The Downtown Business Association does a good job of arranging events like parades and music festivals to draw people to the CBD. One site with 2,500 square feet is available in the CBD.

The community has two primary traffic arteries lined with stand-alone commercial businesses. One stand-alone site is available that has ample parking and a traffic count of approximately 80,000 cars per day passing at 35 mph. This site is the right size, but it is not available to lease; she would have to buy the building. Foot traffic in the mall is the highest, but restrictions and lease payments are higher by far than in the other locations. Not as many people pass by the downtown location, but rent is much cheaper as well.

Questions

1. From the information you have been provided, and considering the advantages and disadvantages of the different types of locations mentioned in this chapter, where would you recommend that Jodi locate? Provide justifications for your recommendation.

2. What additional information would you want to have to make this location decision?

graduated over 250 new businesses with a greater than 80 percent existence rate after five years, helped launch over 600 companies that have generated more than $157 million in revenues, and created/retained over 9,500 jobs. That’s a big impact for a community with an approximate population of 100,000.5

Martek Biosciences might not be a household name, but if you have children, you have probably benefited from its products. Martek graduated from the Technology Advancement Program Incubator in Columbia, Maryland. It develops and sells products derived from microalgae, including nutritional oils contained in infant formula that aid in the development of newborns’ eyes and nervous systems.

Through the incubator, Martek had access to specialized facilities and equipment it would have been unable to use any other way. The scale-up lab helped company researchers determine whether a number of individual cells they had grown in the lab were scalable to a larger market. Martek now has license agreements with 13 infant formula manufacturers representing more than two-thirds of the world’s wholesale infant formula market.6

New ideas inevitably beget new ideas. Incubators are operating at record numbers with some 45,000 start-ups operating in 2,200 incubators across 62 countries in 2018. Survival rate for participants is 87 percent, compared with 44 percent for companies that don’t use incubators.

Support Services. Incubators typically provide office, production, and other equipment for tenants to share, items that young businesses often cannot afford by themselves. These items can improve your productivity as a young business, but they would cost a lot of money if you had to buy them outright. In an incubator, you can have access to such equipment and pay only when and if you use it. Receptionists, secretarial support, and shipping and receiving services are also available on a shared basis, so you don’t have to add to your payroll.

“Incubators typically provide office, production, and other equipment for tenants to share, items that young businesses often cannot afford by themselves.”

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Incubators offer specialized space like commercial kitchens for culinary businesses.

**Professional Assistance**

Incubators often negotiate reduced rates with needed professionals like accountants and lawyers. They also offer training in cash flow management, marketing practices, obtaining financing, and other areas.

**Networking.** Incubators can put you in contact with other local businesses. A “family” atmosphere often develops between businesses located in incubators because all are at roughly the same stage of development. This atmosphere usually leads to an esprit de corps among tenants.

**Financing.** Incubators often have financial assistance available or access to other funding sources such as revolving loan funds, which can provide loans at lower than market rates.

**Specialized Incubators.** Arts incubators exist to provide assistance to artists, arts organizations, and creative enterprises in the early stages of development. They play the role of lowering barriers to artists turning their creations into businesses. In addition to assisting artists achieve a level of economic viability, such incubators engender improvement of a community’s cultural programs, provide creative enhancement, attract other new businesses, boost tourism and visitor traffic, and increase community vitality.7

**Concept Check Questions**

1. What are the three location types and their subcategories?

2. Give an example of a type of small business that would have the greatest chance of succeeding in each location type. State your reason for selecting that particular business type by giving specific advantages.

3. The old adage “location, location, location” applies as well to cyberspace as it does to brick-and-mortar businesses. How does an internet-based business influence its “location”? Which of the principles of location discussed in this chapter apply to e-businesses? What other factors do they have to deal with?

**Concept Module 12.5: Layout and Design**

- **LO 12.5:** Explain the types of layout you can choose.

After you have selected a site, you need to lay out the interior of your business. If yours is a type of business that customers visit, most of your management decisions will be directed toward getting customers into your business to spend money. No matter what type of business you run, this is where the activity happens. How your location is laid out and designed is important because it affects the image and productivity of your business.

**Legal Requirements**

The Americans with Disabilities Act (ADA) requires businesses to be accessible to disabled customers and employees, with businesses having more than 14 employees required to accommodate disabled job candidates in hiring. This law affects the way every business operates. Buildings constructed after January 26, 1993, must meet stricter requirements than those built earlier.
Co-working space offers a new way for people to conduct business in shared space. A company called WeWork has been the proverbial 800-pound gorilla in that space since opening in 2010 and growing to 163 locations in 52 cities around the world.

WeWork’s business model centers on renting real estate space via a variety of plans, cool designs, flexible leases, and services like high-speed internet, reception, mail, cleaning, coffee, and beer. It offers office culture to businesses too small to create that culture themselves.

For growing companies, WeWork offers a way to enter new cities without the hassle of scouting locations, negotiating contracts, designing the space, and hiring vendors. The 150,000 members of WeWork are largely packs of 20-somethings who pay anywhere from $220 a month for the use of a shared desk in an open common area to $22,000 a month for a 50-person office.

Weekly events that range from thought-leader panels to cheese tastings help nurture a strong team culture. Conference rooms, available for groups of 2 or 25, include audio-visual gear and an attractive ambiance.

The question that remains to be answered (in the long term, since co-working is relatively new) is whether co-working is a fad or signals a paradigm shift in the way we work. Research has shown that workers’ primary problem with open or cubicle-filled offices is unwanted noise. But it’s not just the noise that’s the problem. In fact, some level of office banter in the background might actually benefit our ability to do creative tasks, as long as we don’t get caught up in specific conversations. Rather than total silence, some people are more creative with a little background noise. This could explain why they can focus in a noisy coffee shop, but not in a noisy office.

The co-working space movement continues to grow in size, numbers, and variety. Spaces now feature specialization—for example, The Wing, in New York’s Flatiron District features pale pink walls, cozy reading nooks, oversized bathrooms with stocked showers, and a library of books by female writers. A women-only and woman-centric workspace.

• Toilet facilities and water fountains must be accessible to people in wheelchairs.

• Self-service shelves, counters, and bars must be accessible to people in wheelchairs and to the visually impaired.³

Retail Layouts

The layout of your retail store helps create the image that people have of your business. It is important to display merchandise in an attractive, logical arrangement to maximize your sales and to make shopping as convenient as possible for your customers.

Three types of layouts are commonly used in retail stores in various combinations. The simplest type is the free-flow layout, which works well with smaller stores such as boutiques that sell only one type of merchandise (see Figure 12.3). As there is no established traffic pattern, customers are encouraged to browse.

A grid layout establishes a geometric grid by placing counters and fixtures at right angles in long rows (see Figure 12.4). It effectively displays a large amount of merchandise with tall shelves and many shelf facings. Supermarkets and drugstores tend to be set up with this layout, because it suits customers who wish to shop the entire store by moving up and down alternate aisles. But if customers can’t see over fixtures or if they want only one or two specific items, they may find this layout frustrating.

The loop layout has gained popularity since the early 1980s as a tool for increasing retail sales productivity (see Figure 12.5). The loop sets up a major aisle that leads customers from the entrance, through the store, and back to the checkout counter. Customers are led efficiently through the store so as to expose them to the greatest amount of merchandise. At the same time, they retain the freedom to browse or cross-shop. This layout is especially good for businesses that sell a wide variety of merchandise, because customers can be routed quickly from one department of merchandise to another.

![FIGURE 12.3](image_url)

Free-Flow Layout

The free-flow layout encourages shoppers to browse.
\textbf{Grid Layout}

The grid layout routes customers up and down aisles to expose them to a large quantity of merchandise.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{grid_layout}
\caption{Grid Layout}
\end{figure}

\textbf{Loop Layout}

The loop layout allows customers quick access to any department in the store.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{loop_layout}
\caption{Loop Layout}
\end{figure}

\section*{Service Layouts}

Service businesses that customers visit, such as beauty shops and restaurants, need to be concerned about how their layout affects both their customers’ convenience and the business’s work flow. The image of these service businesses is just as strongly affected by layout as is the image of retail stores. Speed of service becomes more critical every year. Consider the decreasing amount of time needed for photo finishing—from one week, to two days, to one hour, to while you wait. Layout is critical to maintaining the speed and efficiency of service providers.

\section*{Manufacturing Layouts}

The layout of a manufacturing business is arranged to ensure a smooth flow of work. The specific layout of your plant will depend on the type of product you make, the type of production process you use, the space you have available, and other factors, such as the volume of goods and amount of worker interaction needed. There are three basic types of manufacturing layouts, which may be combined as needed.
TECH IN ACTION

IF YOU’RE NOT ONLINE, YOU DON’T EXIST

Domain names have been the online real estate for businesses for two decades. As the title of this box says, in the minds of your customers you have to have an online presence in order to exist.

What has become more complicated now is that pretty much every word in the dictionary followed by dot-com is someone else’s personal property. Almost 130 million domain names are already registered.

While dot-com is still the preferred URL, there are other options. Generic top-level domains, known as gTLDs, are new variations expected to become more relevant and change the way we search online. For example, if your small business deals in feline products, it would make sense for your domain name to be dot-cat. If your special skill is making rings, earrings, and bracelets out of exotic wood, wouldn’t a domain name ending with dot-jewelry be better for building your online brand?

While staying in the realm of dot-com, some ways to come up with creative domain names include

- **Use a Catchy Phrase:** Rather than a single name, use a combination of words that customers will relate to your business. For example, realtor Kimberly Schmidt has the domain name GreatHomesInSanDiego.com. Pretty catchy.

- **Use a Call to Action:** Making your tagline your domain name builds your online brand presence and is memorable to your customers at the same time. For example TAG Heuer uses Don'tCrackUnderPressure.com. So, think about what action you want your market to take and turn it into a domain name.

- **Use a Valuation Company:** If you really want a domain name that is already registered, resist the urge to contact the owner. You have a better chance to obtain it (for less) via an intermediary.

Domain names are interesting digital assets. Assets have value, so what is a domain name worth if you want to buy one? Turns out there is huge variation in value. The vast majority are almost without value, while the record price is $35.6 million for insurance.com, sold in 2010. The closer a domain name is to a brand name—especially as a single word—and the more established a site is, the more value the domain name will generate.

Appraisal tools can be helpful in determining a price. Check out EstiBot, Website Outlook, and SitePrice.

Sources:

Process Layout. With the **process layout**, all similar equipment and workers are grouped together so that the goods being produced move around the plant (see Figure 12.6). This layout is common with small manufacturers because of the flexibility it allows. The product being made can be changed quickly. An example of the process layout can be seen in a small machine shop, in which all the grinders would be in one area, all the drills would be in another area, and all the lathes would be in a third area. Restaurant kitchens commonly employ this type of layout as well, with the refrigerators in one place, the ovens in another, and a food preparation area elsewhere.

Another advantage of the process layout is that it minimizes the number of tools or equipment needed. For example, an assembly line (which uses a product layout) might require a company to purchase several grinding machines, one for each point where it is used on the assembly line. With a process layout, by contrast, fewer grinders need be purchased, and they can be used in one area. Because the machines operate independently, a breakdown in one does not shut down operations.

A disadvantage of the process layout is that when equipment is grouped together, increased handling is needed to move the product from one station to another when more than one task is performed. This effort can require additional employees. Because this layout is more general in nature, producing long runs of the same product would be less efficient than in the product layout.
Product Layout. With a product layout, you arrange workers, equipment, and activities needed to produce a single product in a particular sequence of steps (see Figure 12.7). A product layout is best when you are producing many standardized products or using specialized equipment. Auto assembly lines, textile mills, and other continuous-flow assembly lines in which raw material enters one end of the line and finished products exit the other end are examples of a product layout. Material handling costs can be decreased and tasks can often be mechanically simplified so that skilled labor is not needed.

A restaurant that specializes in a product like bagels, pizzas, or cookies can make use of the product layout by moving through a sequence of steps to prepare the finished product. The kitchen can be arranged to store ingredients and mix the dough at one end of the counter before it is all moved to cold storage. Then batches can be removed and processed through a dough-rolling machine; prepared and mixed with other ingredients; and cooked, cut, and served in an assembly-line fashion. The layout works well for making that one product, but what if you want to diversify your menu to offer other food items like hamburgers, French fries, or tacos? You would have to set up separate product lines with new ovens, stoves, and counters for each new product—an expensive way to expand a menu.

A product layout is inflexible because it is costly and difficult to change the product that is being made. It is usually more expensive to set up than a process layout because more specialized machinery is needed. A breakdown anywhere along the line can shut down the entire operation. The specialization needed for a product layout eliminates this option for most small businesses because of cost reasons.

Fixed Layout. In a fixed layout, the product stays in one spot, and equipment, material, and labor are brought to it as needed for assembly. Types of businesses using this layout include

**FIGURE 12.6**

Process Layout in a Restaurant Kitchen

In a process layout, similar equipment is grouped together in areas to complete specified tasks.
building construction, aircraft- and shipbuilding, and other large, immovable product production.

**Home Office**

Is a home-based business right for you? It is a popular option for business owners. Small Business Administration data show the share of businesses that are home-based has remained relatively constant over the past decade, at about 50 percent of all firms. Specifically, 60.1 percent of all firms without paid employees are home-based, as are 23.3 percent of small businesses with employees. The industries in which businesses are most likely to be home-based are information (70 percent); construction (68.2 percent); and professional, scientific, and technical services (65.3 percent). Let’s look at some advantages and disadvantages.

**Advantages**

- **Flexibility in scheduling personal, family, and business obligations.**
- **Low overhead expenses.** You are already paying for the space you live in and utilities.
- **No commute time.** Of course, that walk from the kitchen to the office can seem like a long one if you don’t really feel like working.
- **Independence.** You can be your own boss and your own landlord. You have some degree of control over what work you accept and the schedule for doing it.
- **No office distractions.** A lot of time can be wasted in office settings chatting with people who “pop in.”

**Disadvantages**

- **Interruptions.** It’s hard for family and friends to understand that you really do have work to do.
- **Isolation.** Much of the social aspect of work can be lost without contact with others. A house can get very quiet and lonely.
• **Credibility.** Although home-based businesses are much more accepted today, being taken seriously as a business can be a challenge. This isn’t a hobby, and you are not unemployed.

• **Work space.** Your working area may be cramped and not too private.

• **Zoning issues.** Be sure to check whether it is legal for you to operate a business out of your home.

The approaches to running a home business are as varied as the millions of entrepreneurs who own them. Equipment needs vary almost as much.

You must make sure that it is legal to operate a home-based business where you live. Some communities have adopted tough restrictions, such as not allowing a home office even for work you bring home from your “real” office. More typical concerns involve complying with zoning regulations that govern parking, signage, and types of businesses allowed in residential areas. Check with your local zoning board.

### Concept Check Questions

1. What is the ADA, and how does it affect the small business owner’s site layout and design plan?

2. What are the main types of layout plans, and what should the entrepreneur focus on when designing the layout plan for a new business?

### Concept Module 12.6: Lease, Buy, or Build?

• **LO 12.6: Present the circumstances under which leasing, buying, or building is an appropriate choice.**

You have three choices of ownership for your location: leasing a facility, purchasing an existing building, or building your own. In this section, we will discuss the relative advantages of leasing or owning your building.

#### Leasing

A lease is basically a long-term agreement to rent a building, equipment, or other asset. The biggest advantage of leasing is the amount of cash you free up for other purposes. Not only do you avoid a large initial cash outlay through leasing, but you also reduce your risk during the start-up period. Once your business is established, your needs may change. Leasing your business premises can give you the flexibility to move to a bigger, better, or more suitable location in the future.

A disadvantage of a lease is that it may prevent you from altering a building to fit your needs. You also do not have long-term assurance that you can stay in the same location. The owner may decide not to renew your lease at the end of the term or may increase your rent payments. Leased space in shopping centers commonly requires a monthly fee based on square feet of space, plus a percentage of gross sales.

Review any lease with your lawyer before signing it. This advice holds true for any legal document, but with a lease there is a tendency to think, “These forms are pretty much standard,” and thus ignore the advice to review them first. Remember who drew up the document—the lessor. Whom do you think the conditions of the lease will favor? Not you, the lessee. You may need to negotiate the provisions of the lease or escape clauses. These items can allow you to terminate the lease if your circumstances change drastically. You will also want to consider the lease’s renewal options. Will the lease allow you to remain in the same location at the end of the lease period?
leasehold improvements
Changes that make a property more valuable, such as painting, adding shelves, or installing new lighting.

gross lease
A lease in which the monthly payment made by the tenant remains constant and the landlord pays the operating expenses of the building.

net lease
A lease in which the tenant pays a base monthly rent plus some or all real estate taxes of the building.

net-net lease
A lease in which the tenant pays a base monthly rent plus real estate taxes and insurance on the building.

triple-net lease
A lease in which the tenant pays a base monthly rent plus real estate taxes, insurance, and repairs. Utility bills may or may not be included. In a net-net lease, the tenant pays some or all real estate taxes on top of the base rent. A net-net-net, or triple-net lease, requires tenants to pay not only the base rent, taxes, and insurance, but also other operating expenses related to the building, such as repairs and maintenance.

percentage lease
A lease in which the tenant pays a base monthly rent plus a percentage of gross revenue.

escalation clause
A lease that varies according to the amount of inflation in the economy.

Leasehold improvements are important considerations to negotiate. They comprise the improvements you make to the property, such as upgrading lighting or plumbing, installing drop ceilings, building walls, and making other changes to the property. Of course, you cannot take these improvements with you when you leave, so try to negotiate rent payments in exchange for them. These are just a few of the factors you need to negotiate before signing a lease. Get all agreements in writing.

The best way to avoid disputes between landlords and tenants is for both parties to understand the lease agreement before it is signed. Because a lease will legally bind you for a long period of time, you should have the following questions answered to your satisfaction when you enter the deal:

1. **How long will the lease run?** The length of most leases is negotiable, with 3 to 10 years being typical and even one-year leases written with 10 one-year renewal options. In the past, landlords wanted the lease term to be as long as possible to hold down their vacancy rates. Now, in areas where vacant office space is at a premium, many businesses want long leases as a hedge against rising prices. For example, in New York City, an office tower may charge $60 per square foot a month for rent today, whereas the same offices rented for a monthly $16 per square foot only five years earlier.

2. **How much is the rent?** Be sure you know the dollar amount per square foot of space that the rent is based on for any location you consider. Find out how much you are paying for different kinds of space—you don’t want to pay the same dollar amount for productive office space as you do for space like lobbies, hallways, mechanical areas, and bathrooms.

There are at least five types of leases, which calculate rent differently, though they are all based on square feet. In a gross lease, the tenant pays a flat monthly amount. The landlord pays all building operating expenses such as taxes, insurance, and repairs. Utility bills may or may not be included. In a net lease, the tenant pays some or all real estate taxes on top of the base rent.

A net-net lease adds insurance to the tenant’s responsibilities along with base rent and taxes. A net-net-net, or triple-net lease, requires tenants to pay not only the base rent, taxes, and insurance, but also other operating expenses related to the building, such as repairs and maintenance.

3. **How much will the rent go up?** To protect against inflation, most landlords include an escalation clause in leases, which allows them to adjust rent according to the consumer price index (CPI) or some other scale. You should not agree to pay the full CPI increase, especially if you are already paying part of the building operating expenses.

4. **Can you sublease?** There are many reasons why you might not be able to stay in a location for the stated duration of the lease, including, at the extremes, a failure of your business or becoming so successful that you need to move to a larger space. If you must move, can you rent your space to another tenant who meets the same standards the landlord applies to all other tenants?

5. **Can you renew?** Unless a clause is written into your lease that guarantees you the first right to your space at the end of the lease term, the landlord has no legal obligation to continue it. A formula for determining the new rent payment might be included in the renewal clause, or you might pay current market rate.

6. **What happens if your landlord goes broke?** A recognition, or nondisturbance, clause can protect you from being forced out or into a new lease should the property change ownership.

7. **Who is responsible for insurance?** Landlords should be expected to carry a comprehensive policy on the building that includes casualty insurance on the structure and liability coverage for
all public areas such as hallways and elevators. Building owners can require tenants to buy liability and content insurance.

8. What building services do you get? Your lease should state the specific services you can expect to receive, including any electricity use limits, cleaning schedules, and heating, ventilation, and air conditioning (HVAC). Note that, unlike residential rents, commercial space does not usually come with 24-hour HVAC service. (Monday through Friday from 8 a.m. to 5 p.m. and Saturday from 8 a.m. to 1 p.m. are normal.) This could produce some hot or cold working conditions if you work at other hours.

9. Who else can move in? Clauses can be written into leases that restrict direct competitors, or businesses that are exceptionally noisy or otherwise disruptive to others, from locating in adjoining spaces. Remember that such restrictions can become a problem to you if you need to sublease.

10. Who pays for improvements? Construction and remodeling become expensive quickly. Although you are usually allowed to make leasehold improvements, the building owner does not always have to pay for them. Improvements are an area wide open to negotiation in leases—make sure all agreements in this area are in writing.

Purchasing

The decision to buy a building can be a difficult one. Ownership increases your upfront expenses and the amount of capital you need. The major expense of purchasing and remodeling can drain already stretched resources from other business needs.

With ownership, you gain the freedom of customizing the property any way you want. You know what your payments will be. At the same time, you are tied down to that location much more if you own rather than rent the property. Tax considerations enter the picture. Although lease payments are deductible business expenses, only depreciation on the building is deductible if you own it. Finally, the value of your investment is subject to the whims of the local real estate market. The value may appreciate or depreciate for reasons that have nothing to do with your own efforts. In the end, the choice comes down to economics and flexibility. Because most entrepreneurs are in business because of what they make or sell, and not in the “brick-and-mortar” business of real estate speculation, a majority will choose leasing.

Building

Building a new facility to meet your own specifications may be necessary if your business has unique needs or if existing facilities are not located where you need them, which may be the case in some high-growth areas.

As with buying an existing property, building a new facility greatly increases your fixed expenses. Will your revenues increase enough to cover these additional expenses? On the plus side, building a new facility may enable you to incorporate new technology or features that will lower your operating costs compared to using an older, existing building. Look at your total costs over the long term when making this decision.

Concept Check Questions

1. Compare and contrast the advantages and disadvantages of buying, building, or leasing space for a small business.

2. Most commercial leases are triple-net, rather than gross leases (like residential leases). What does that mean you are paying for each month in addition to the rent you pay per square foot?
CHAPTER REVIEW

SUMMARY

LO 12.1 Describe small business distribution and explain how “efficiencies” affect channels of distribution.

The purpose of a channel of distribution is to get a product from a producer to consumers as quickly and cheaply as possible. Because distribution represents such a large portion of the price of many products, selecting the most efficient channel will help keep costs down.

LO 12.2 Explain how the location of your business can provide a competitive advantage.

Competitive advantages can be built on many factors. If the location choice of your business makes your product, good, or service more accessible to your customers, to the point where they buy from you rather than other sources, then location is your competitive advantage.

In deciding where to locate your business, you should consider the price and availability of land and water, the labor pool from which you can hire employees, accessibility to customers and suppliers, closeness of competition, adequacy of transportation, public attitudes toward new businesses, taxes and regulations, your personal preference about where you want to live, financial incentives offered, and the quality of life available.

LO 12.3 Discuss the central issues in choosing a particular site within a city.

The most appropriate site for your business is determined by answering specific questions related to matching the needs of your business with the type of site, accessibility, legal considerations, and economic factors.

LO 12.4 Compare the three basic types of locations.

The three types of locations you may choose are central business districts (CBDs), shopping centers, and stand-alone locations. The CBD for most cities and towns includes the original “downtown” area, so it is usually the oldest urban section. Shopping centers can range from small strip malls that serve the local neighborhood to very large regional malls that draw customers from hundreds of miles. A stand-alone location places your business apart from other businesses.

LO 12.5 Explain the types of layout you can choose.

For retail businesses, a free-flow layout encourages customers to wander and browse through the store. A grid layout moves customers up and down rows of shelves and fixtures. A loop layout features a wide central aisle that leads customers quickly from one department to another. For manufacturing businesses, a process layout groups all similar equipment and jobs together and provides the flexibility needed by many small manufacturers. A product layout arranges equipment and workers in a specific sequence to produce products in a continuous flow. With a fixed layout, the product being made stays in one place, while equipment, materials, and labor are brought to it.

LO 12.6 Present the circumstances under which leasing, buying, or building is an appropriate choice.

When deciding whether to lease, buy, or construct a building, you need to consider how long the building will be suitable for your business and whether you can afford to tie up your capital, which could be used for other purposes. Before leasing, you need to carefully examine the terms and conditions of the lease before signing it.

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12.1: Small Business Marketing: Location Channels of Distribution

LO 12.1: Describe small business distribution and explain how “efficiencies” affect channels of distribution.

Read the scenario and then decide which channel of distribution has been used, placing the letter that corresponds to your answer in the blank.

A. Retailers  B. Agents  C. Direct Channel  D. Brokers  E. Target Market  F. Wholesalers  G. Indirect Channel  H. Dual Distribution  I. Originator

1. _____ Jane is excited. She found a swimsuit she likes at a local retailer but they did not have her size. Tonight she is ordering the swimsuit in her size online.

2. _____ Brett grows wheat that he sells to a co-op, which then sells the wheat to a flour company, which then sells the wheat to a bakery, where Carrie buys her bread.

3. _____ Amy’s business buys fresh produce in bulk from local farmers then sells the fresh produce to local restaurants and cafeterias.

4. _____ Kathy’s store sells top-of-the-line cosmetics. Her customers range from high school girls to women over the age of 90.

5. _____ Jake is buying his first home. He is using an intermediary who is bringing him as the buyer of the house together with Stephen who is selling the house.

6. _____ Sally sells her fresh farm eggs to her neighbors every week.

7. _____ Nicole represents her buyer who purchases peaches for making jam. Nicole never takes title to the peaches.

Explain how a small business could add value in each channel of distribution listed above. Be specific.

12.2: Small Business Marketing: Location

LO 12.2: Explain how the location of your business can provide a competitive advantage.

Read the scenario and then answer the following questions.

Taylor and Rick are moving to a smaller community to raise their young son. While good for their business, the large metropolis where Baby Boutique is currently located is not where they want to be. Business has been great for the last five years and customers come from miles around to visit their store. They sell all things related to babies: bassinets, baby monitors, cribs, rocking chairs, clothing, scrapbooks, christening gowns, mobiles, toys, and much more. In fact, they will even come in and design your nursery, implement the design, and supply all the needed furnishings. Then as the baby grows, they will change out the furniture and décor to mature with the baby. Customer service is their top priority.

In order to be settled by the first day of school, time is of the essence. They contact a realtor in their new community, share the needs of their business, and ask her to find an adequate location, within the parameters of needed space, rent expense, and so on. The realtor finds a location for their store and sends them pictures. All looks good, and they sign a five-year lease. The next day, they, all their belongings, and their entire store are packed and ready to move.

They have rented a great house in a good neighborhood with an awesome school district and as soon as they arrive at their new home, they feel comfortable and welcomed. Not so as they drive up to the building on which they have signed a five-year lease. Driving to the location, they begin to get worried. They have gone
from an upscale area to an area that is economically challenged. And as they drive up to their storefront, they note that on one side is a liquor store and on the other side is a pawnshop. Furthermore, the building is basically a steel warehouse with bars on the windows. All the traffic flow in the area appears to either divert to the liquor store or drive by the building. There are no other businesses within walking distance. Slowly they climb out of the moving truck. How will this new location work?

Answer the following questions about the site of this business. You must be able to defend your answers.

1. Is the site located near their target markets? Who is their target market? Be specific.

2. Is the type of building appropriate for the business?

3. How large is the potential trade area for the business? Will people travel to their store?

4. Will adjacent businesses complement or compete with their business?

5. Will the natural traffic flow complement their business?

6. What types of leasehold improvements and other one-time costs will be needed?

7. In detail, describe the ideal location you would choose for this business, and be sure to include the socio-demographics of the target market.

CHAPTER CLOSING CASE ➤

Big-Box or Specialty Shop?

Lance Fried is an electrical engineer who loves to design new products. He and a buddy were watching surfers and scenery at the beach near his home in Del Mar, California, when the buddy dropped his 20 Gig iPod into a cooler full of water and ice. The trashed iPod gave Fried an idea—to make an MP3 player that would work underwater.

Fried spent months tinkering with his invention, a waterproof MP3 player designed specifically for athletes who need tunes while surfing, swimming, waterskiing, or snowboarding. Like most entrepreneurs, Fried had invested his personal savings but he had also somehow convinced half a dozen friends to work for him for free (pretty smooth).

By August 2004, Fried finished a working prototype and created his company called Freestyle Audio. The player was lightweight (40 grams), with a 40-hour battery, and lots of memory (for 2004). The headphones wrapped tightly around ears, and all of it was waterproofed using a proprietary technology. He projected to sell the units for $180.

It was then that Fried brought Greg Houlgate into the story. Houlgate was a friend who served on Freestyle’s board and had worked as a sales strategist for a number of large sporting goods companies, including Callaway Golf. Houlgate showed the player to some of his contacts in the big-box retail world. “I’ve never had such a quick and positive response on any consumer electronics,” he says.

Fried was amazed when Houlgate told him that major retailers—including Best Buy and Bass Pro Sporting Goods—wanted to put his gadget on their shelves side-by-side with players by giants like Apple and Sony. Fried knew that such a deal with just a single big chain could be worth an instant million dollars in revenue.

But the idea also scared Fried. Distribution via mass retailers had never been part of his San Diego start-up’s plan. Instead, the idea always had been to start small, selling through specialty shops. A big-box strategy meant a whole new business plan—one that would involve mass production and a potentially huge up-front investment. Oh yeah, and retailers wanted the players in time for the holiday shopping season, which was just four months away.

How, or should, Freestyle capitalize on that interest? Fried quickly convened a meeting of his three-man board at Jimmy O’s, a local ocean-view hangout. Houlgate presented the good news to the third partner, Mike Brower. “Mass distribution gets your name out fast and gives you an instant hit,” Houlgate said. “Your vendors really start to take you seriously.” That wasn’t the only advantage. With mainstream retailers on board, it would be easier to attract investors. That part appealed to Fried, who was ready for money to come into rather than out of his own bank account.

But Brower, CFO of the popular sunglasses company Spy Optic, was not jumping on board. His experience working at sporting goods companies had always been to start small, get an influential niche group to love you, and go for bigger distribution deals only after that groundwork had been laid. How would Freestyle get its key customer groups—surfers and snowboarders—into big, unhip retail outlets like Best Buy and Bass Pro? And what would Freestyle have to give for the privilege of a good position on big-box shelves? “They’ll make you a commodity if you don’t know how to negotiate, asking for discounts that just kill your margins,” Brower said.

Ramping up production would be no small feat in itself. It would require a significant capital investment. How could Freestyle find that kind of money? Would the company’s manufacturing partners be able to maintain quality if orders suddenly spiked? How would the company get more attention than competing MP3 player brands manufactured by corporate giants and backed by multimillion-dollar marketing campaigns?

Fried had to make a huge decision—fast. The action sports retail trade show—where independent retailers go to test and order new gear to sell at their surf, dive, skate, and snowboard shops
for the holiday season—was just weeks away. Making a big splash at the show had always been part of Freestyle’s plan. If Fried signed on for a big-box deal, that plan would have to change.

Questions

1. Can Fried really say “no” to the big-box retailers? Why or why not?

2. What do you think Fried should do?