

## THE SITE SELECTION STRATEGIES OF ENTERPRISES

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### **— Abstract —**

In trade the market is shifting among the store types in such a degree that significantly changes the market positions of the actors in the sector. This competition is not simply about store types but ownership structures and network relationships as well. In this contest no trader can maintain a position without reviewing his or her business strategy. On macro-level the increase in consumption stopped, and economic policy (can) affect the directions of the following years' business development by the so-called plaza stop. Although the macro-level environment trends favor no ramp up in the retail sale, the plans for development and store openings did not decrease in numbers. For the entrepreneurs it has never been more important to have professional plans – so-called site selection strategies – than now. In my article I present a method based on the complex examination of the planned operating environment. There is abundant literature on both the mapping and the methodology presentation of company resources and macro-level strategic factors, so my analysis is more about the so-called meso-level, i. e. regional and locational economic factors

affecting site selection. There are only a few areas of economy where the impacts and reactions between the entrepreneur and his/her immediate environment can be tracked in such extent as in trade. The economic examination of the trade enterprises' decisions about site-choosing got its place in regional economics only in the 20th century. In practice, the scientific methods did not come into general use, and there are only a few methods used widely in business life too. In my analysis I would like to assist with the development of such a method.

**Keywords:** *trade, demand, strategy, site, location, catchment area*

**JEL Classification:** F 10

## 1. TRADE IN LOCATION THEORY

Location theories typically cover the operational and spatial analysis of agricultural or industrial units. Economic operators are trying to find an optimal location by business calculations, and the recognition and conscious examination of thereof was a great step in the development of location theories. The circle of measurable (calculable) economic factors gradually broadened, and the unmeasurable characteristics came into prominence as well, but trade appeared in the development stages of location theories as no independent economic area for a long time. The spatial dimensions of the goods-producing economy (specialization, division of labor), the mass transportation of raw materials and finished products (transport infrastructure, transportation equipments), and the free movement of capital and workforce are all general requirements of economic activities (*Rechnitzer et al., 1999*). The agricultural location theories (first third of the 19th century) covered explanations on the spatial localization of the agricultural production, the sites, and the related connections; while the industrial location theories (first decades of the 20th century) covered explanations on the installation locations of industrial plants. The analysis of trade opportunities appeared first in examinations performed between the two World Wars (e.g. Lösch), and out of the factors for selecting a site they put the maximization of income into prominence, and instead of production they took the characteristics of consumption into account. By the optimization of informatics-based, i. e.

mathematical models (e.g. Isard) – formed by considering all the factors needed for the determination of installation location – developed in the second half of the 20th century such functions in trade were supported as, for example, the territory management. Today location theories take such non-economic motivations and non-measurable factors (e.g. the influence of individual experience) into consideration that can be utilized by trade enterprises in their decisions about selecting a site.

## **2. COMPETITIVENESS RELATIONSHIP BETWEEN THE TRADE ENTERPRISE AND THE OPERATING LOCATION**

In the traditional approach company advantages are determined by the macro-economic conditions on the one hand, and the effectiveness of company operation accompanied by the refinement of the company's strategy on the other hand. The experience of the past years shed light on the fact that – especially in the case of trade enterprises – on the long term, the quality of the local business environment, and the level of regional and local economy development determine the competitive advantages of the enterprise and the operating environment. I present the sources of the competitive advantages of trade enterprises, namely the identification of site selection factors by Porter's diamond model. Porter named four interrelated determinants (*Lengyel, 2010*).

### **2.1. Factor (Input) Conditions**

Production factors can be separated into two groups:

- (a) Resources: natural resources, human resources, financial resources
- (b) Infrastructure: Technical infrastructure, administrative infrastructure, information technology infrastructure, scientific and technological infrastructure

In decisions connected to the trade enterprise the *development state* of transportation network in a region or settlement may be critical because of the scantiness of input conditions. If we take the divisional characteristics, the *specificities* into consideration, then the development strategy of the trader is

determined by, for example, the local administrative infrastructure (e.g. the regional construction specifications).

Sustainability and environment protection are special but highly prioritized criteria in trade. Today, in the evaluation process of building permissions it is acutely investigated if the investor fulfills the professional requirements. Sustainable trade means that such environmental impacts as the expected emission, the degree of noise pollution, and the waste management plans are examined for the authorization for the installation of a new store. The commitment of the trader in the installation and operation of a sustainable commercial establishment that operates with responsibility towards the environment is often proved by an ISO certification. According to the experience the noise and air pollution from traffic can be significantly reduced by developing the transportation network and building new roads in connection with the installation of a new store. The realization of the spatial plans' specifications can mean significant development in the infrastructure of the area in line with the construction of the store. The safety and modernity of the energy supply networks (gas and electricity) may advance, and most of the time the investor takes professional care of green spaces by forming and regularly attending them. If the local resources are scarce, these could have been realized in long term or not at all. Of course, the local government's regulations and requirements for these developments are also important aspects of site selection.

The building permission for a commercial building with total floor area above 300 m<sup>2</sup> requires an exemption request to be submitted, and in the case of commercial buildings with total floor area above 5000 m<sup>2</sup> an impact study is also needed, for which the content elements are determined in the appendix of the Government Regulation No. 367/2011. (XII. 30.). In the impact study the entrepreneur has to find answers for questions about, for example, the demographic indices of the catchment area, the planned retail traffic of the store, the expected changes in purchasing power, and the expectations of the commercial building's impacts on rural development, environment protection, and economy.

## 2.2. Demand Conditions

The analysis of **trade factors** gives essential information for determining and planning the purchase power of the operational region. The purchase power of the settlement and the catchment area depends on the population's size and disposable income per unit. Besides the level of the local demand, its composition and the segmentation of its structure are also important factors in examining and forecasting consumer needs. It is important to recognize what economical, technological and social factors the change and measure of increase in demand depends on. Through their purchases consumers from other regions (e.g. abroad) may directly contribute to the economic development of the region by the so-called multiplier effect. The income spent this way increases the profit of the trader, which means more tax revenue and maybe an increase in the level of employment.

The basis of calculations of a new store's expected sales is the estimation of expected purchase power, which requires the determination of the catchment area. Determining the operational region is one of the most complex dimensions of business development, because besides even the most sophisticated mathematical and statistical methods the experiences of leaders and experts are not negligible, so these subjective elements are incorporated into the decision-making process. For example, the borders of market zones are determined by travel time, and besides divisional standards the trader's experience and local knowledge is also required for the identification of primary, secondary and tertiary zones based on the consideration of travel times in minutes as well as for the calculations of the number of consumers per zone. The catchment area is often determined by more than one methods used concurrently. One of the most common methods is the control or additional calculations based on Reilly's gravity model. This is a geographical model that describes the flow of people between two settlements, and based on geographical location it can be examined that which of the competing stores will be preferred by the consumer. The model considers both the population of the examined settlements and the distance between them, and so the designation of several settlements makes it possible to outline the theoretical borders of the catchment area.

It should be kept in mind that the mathematical method used for the estimation of purchase power in the catchment area can be sophisticated as it is, in the decision-making process no *correctional factors* like the store type, the selection of goods, the traffic and the competitors' location should be ignored. The decision about the spatial position has aspects like how centrally the store is located, and how much the cost of the property or the rental fee will be. Choosing an appropriate property development strategy is influenced by the store type too, because it is not the same if the trader opens a “lonely shop” or a shop in a planned trade zone. So the property and business development strategies are influenced on middle and long term by how elaborated the local urban development conceptions are.

### **2.3. Related and Supporting Industries**

The saying “never manage alone” prevails markedly in trade, because in this sector it is especially true that networks and strategic partnerships are competing each other instead of “lonely” companies. The success of the trader depends on *the quality of his or her relationship with the suppliers*, and because the suppliers are parts of the supply chain system, the prices and quality of goods depend on the level and reliability of the partnership. The operators in related industries are not competitors, but they may be useful, for example the logistics providers have influence upon the transaction costs of the distribution channel, and consequently on the competitiveness of the trader as well.

Many a time a multinational corporation appearing in the region formulates the sustainability expectations determining the supply chain too. The system of IKEA IWAY is a good example of this. The chain store defined such requirements for its suppliers that may affect the site selection; for example IKEA defines standards on environment protection and working conditions. The former contains aspects like conditions on the safe handling of chemicals and other materials dangerous for the environment; the latter system of conditions contains such typical instructions as compliance with the human rights, and the creation of work conditions that are safe and unharmed to health. The performance of the supplier

is measured by the IWAY sustainability index, and the minimal expectations are predefined.

A new store's effect on the local market opportunities is important because in favor of decreasing the logistics costs suppliers tend to offer the cheap products of local growers and manufacturers, and so they ensure a market for goods produced locally. If the local suppliers represent considerable weight in the supply of goods, then that has a benevolent effect on the region's GDP changes through the activity of the local economy. In the related, non-competitor cooperation a new operator's provider function may cover both an introduction of and a demand for the work of various local small enterprises, thus it creates market for the local provider SME sector. The level of supplier partnerships is also a factor in site selection, so it is important for the quality and cost-benefit ratio of goods in the supply chain to ensure a competitive service.

#### **2.4. Firm Strategy, Structure and Rivalry**

The strategies of commercial companies differ from each other in characteristics like the capitalization of the owners, their local or cross-border activity, and the sale of daily or durable consumer goods. I summarize the characteristics of the retail trade sector's typical strategic options in Table 1. Strategic options are chosen in the following framework:

- Strategy resulting in integration, capital transfer or strategic partnership – This strategic direction is observable mainly in the case of small shops' organized networks, and may be in relation to intensive regional expansion. Positioning has a key role; a good example for this strategy is the Coop network's exceptionally conscious expansion basically in small and medium settlements.
- Product (service) centered or diversification strategies – Based on market position and capital resources, hypermarket development is especially strong in this strategy, supported by intensive marketing. Think about the so-called mass retailer business policy and expansion strategy of Tesco.

- The so-called “turnaround” strategies serve to slow down and stop the decline and ground loss of the enterprise – The independent small shops can survive by keeping the cost level low or developing a product portfolio of narrower but deeper selection. One of the conditions of survival for an independent shop selling daily goods may be a segmentation business policy that satisfies the needs of the targeted consumers on high level.

**Table-2: Main trade strategies**

Strategy Types	Main Characteristics	Goals
“Mass Retailer”	The same marketing mix for everyone	Biggest market share
Diversification	“We are different, but we talk to everyone”	To be different from the competitors
Segmentation	Consumer needs are in focus	Serving a few selected segments
Positioning	Market position is compared to the competitors	Exploring uncovered markets
“Nicher” or “niche-seeker”	Well defined market segment	Special, high quality service
Category Killer	Quick adaptation to the market, flexible service	Trade strategies

Source: Samli; 1998

One of the most typical dimensions of the competition between the Hungarian retailers is the rivalry between the store types. Regarding the daily consumer goods sale the change in the market share values shows a very definite trend. In the early 2000s the share value of hypermarkets and supermarkets was 29-30%, and it is 41-43% now, but in two or three years this share value may reach 45%. From this, the current market share of hypermarkets is 24-26%, but their expansion significantly slowed down in the recent years (*GFK, 2011*). Only the organized networks of small shops reached a greater degree of expansion; their share value doubled, and currently it is 16%. During this change in the market structure independent small shops suffered the greatest casualties, and their market share value decreased to 11-12% from 28% measured in 2000. If this trend



continues, they will reach the ten percent threshold in three years. So far, it is hard to estimate where the so-called Plaza Stop Act will divert the market share changes. MNEs sensibly held their investments back, and regarding the daily consumer goods retail trade both the expansion of Hungarian owned franchise networks and a speed-up of this expansion are expected. The big question of the following years is if the expansion of retailers specialized in operating shops with small floor space would compensate for the decrease in the investment hunger of foreign owned companies, and for the related multiplier effect (e.g. the performance drop of the building industry).

Site selection is basically influenced by what store type the entrepreneur would like to open his or her shop in. Hypermarkets, supermarkets and shopping centrals are typically built in agglomeration areas and on properties nearby cities – the basic reason is the cost of operation and property development, but in the same time building up an infrastructure (e.g. roads and public utilities) may mean additional burden that should be considered. Opening a new store with big floor space in downtown may be profitable if trade gets priority in the local government's region development policy. In this context a most terrible example is the several decades long withering of trade life on the Grand Boulevard of Budapest. It seems unique that all the countless concepts on revitalizing the downtown and the city central(s) failed. There are only a few capitals in Europe where the quality of trade services declined so much in the city central – the result is a cityscape that cannot be called even “Balkanian”.

Besides the issues detailed above the opening of a new shop brings the need for an examination of the market position of the already operating enterprises in the region or settlement. Although the consumer goods retail trade is one of the industries showing the economically cleanest market competition situation, the economic policy always aims to bring one or the other store type into better position by “more or less delicate methods”. The real professional considerations are often lost in the communication campaigns. We know the “big fish eats little fish” type of messages well enough, and objective observations rarely come out of the workshops. It would be interesting to examine how the audit methods tested on other areas of economy would work in the case of this trade industry. The

Herfindahl-Hirschman Index (HHI) would be a useful method as the indicator of the market concentration in the region. The HHI is commonly used by oversight bodies of the state (for example, in communications and logistics) to find if the market situation is in danger. With Huff's Gravity Model the expected distribution of purchase is determined by the floor space of the market centrals and the travel times it takes to reach them. By this we can model the degrees of market presence. In the case of opening a new shop the proper estimation of changes in the market share values can be critical in forecasting the changes in the sales of the region (Levy-Weitz, 2009).

### 3. CONCLUSION

Regarding site selection the consideration of strategic factors presented in the article may help in a more complex professional grounding for the corporate planning on the one hand, and in the transparent communication of the administrative decisions (e.g. the processes of "plaza stop" -like decisions) on the other hand. This latter may have evaluation aspects by which both the entrepreneurs and the representatives of the government (the Committees) can get clear methodological guidelines about how the opening of a new shop can contribute in the development of a settlement, and what impact it has on the realization of the investor's business goals. These can be examined only together, because their multiplier effect is produced by their mutual effects on each other.

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