Pick n Pay has no intention to buy out shared stores

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Buying out its franchisees is a move that has paid off handsomely for Woolworths, which went on to build a roaring multibillion-rand food business.

Spar still operates an almost fully fledged franchise model, even after it had to bail out some of its store owners not too long ago.

Would rival Pick n Pay, currently in recovery mode, ever track the same course and go corporate-owned or remain with its shared-store strategy?

Chris Reed, franchise division director at Pick n Pay, says they have no intention of pursuing a strategy of buying the stores. "It's an important part of our business. [We started franchising] to reach customers in areas that were perhaps difficult to trade in, and also where you needed specialist managers who you could match to that community in predominantly smaller units," he says.

Franchised stores

Of the grocer's 1100 stores across the country, about 450 are franchised across its formats.

Pick n Pay franchised its first store 21 years ago, after founder and then chairman Raymond Ackerman visited supermarket group Albert Heijn in Holland.

The Dutch chain had just given an outlet to an employee because it was not working as a profitable corporate store. On his return, Ackerman franchised an underperforming store in Durban.

As it doesn't tie up any capital for a retailer, franchising can be quite lucrative.

So if Pick n Pay buys All Gold tomato sauce, whether the product goes to franchises or to Pick n Pay-owned stores, it has the benefit of collecting a volume rebate from Tiger Brands and receives payments within 30-odd days from its franchisees.

Expanding store network

While fostering entrepreneurship and creating jobs are key constituents of franchising, it's also a low capex way of expanding a store network that allows a chain to access sites that would not necessarily support a corporate store.

"Pick n Pay has lagged its peers in terms of space growth, leading to market share losses. Franchising was a nice way of accelerating its [store] opening programme," says Alec Abraham, a senior equity analyst at Sasfin Securities.

"Investing in its distribution infrastructure is the big thingfor Pick n Pay right now . arguably it doesn't have much money to open as aggressively as . it wants, so opening franchises is a way of expanding its footprint. I don't envisage Pick n Pay buying out its franchises. Richard Brasher [Pick n Pay's CE] has indicated he finds it very educational dealing with the franchisees," Abraham says.

Low margins

On the flip side, the low-margin nature of operating a franchise, as well as the desire for full control of one's brand tends to drive retailers towards a corporate-only strategy.

The conversion of its 79 franchise stores in SA and Africa over the past four years has cost Woolworths R1,1bn.

Syd Vianello, an independent analyst, says Woolworths realised its franchisees were making top dollar in profit.

"Here we have a business called Woolworths that's printing cash like never before, so they said to themselves: let's use that cash pouring into the bank that we don't know what the hell to do with and buy these guys out," he says.

Ultimately, the Woolworths business was simplified to create uniform ordering and merchandising processes.

Paula Disberry, Woolworths director of retail operations, says it has given the retailer control over its brand, improved profitability, and created a more consistent experience for customers.

There may have been another reason the model was no longer appropriate for the group.

Low investment

Certain Woolworths franchisees were not investing in their stores, leading to low stocks, and this was badly affecting its brand, says a portfolio manager who could not be named, in line with company policy. "Their decision was a bit defensive. But Woolies never really had the operational intensity to run a volume business efficiently," he says.

"When Simon Susman was the CE, he was this pie in the sky strategic guy, whereas Ian Moir is more aggressive and assertive when it comes to managing costs ... the decision to take the franchises back was made before he got in."

Fundamentally, Pick n Pay's "pile 'em high, sell 'em cheap" offering, which is volume driven, is a very different business to Woolworths' fancier proposition.

"Generally, the Pick n Pay franchisees have been pretty good in running the stores, similar to the guys in the Spar stores . it's a model that works well for both of them," the portfolio manager adds.

Forecourt store

Pick n Pay also has 30 forecourt stores at BP fuel stations, with another 17 scheduled to open in this financial year.

According to Vianello, Pick n Pay ought to be buying out its franchisees.

"In the longer term, franchisees make damn good money and if you have a price to earnings ratio as high as Pick n Pay's ... if you can buy them out effectively using very expensive paper then you get a major financial benefit, at the same time . there would be a substantial benefit for shareholders here," he says.

Though buying out its franchises wouldn't fix the Pick n Pay business or directly aid its turnaround through operational issues, it would certainly improve profitably at the group, once SA's leading food retailer.

Source: Financial Mail