Business location

Peter Stimpson *considers why business location decisions should not be taken lightly*

Where to locate a business is one of the most significant decisions managers have to take. It can have an impact on many different departments of a business and, ultimately, on the profitability and chances of success for the whole firm. Table 1 outlines some of the problems that can arise from a poor location.

It is also important to remember that location decisions are:

- strategic — as they are long-term and impact on the whole business
- not easily reversed — due to the costs of relocation
- taken at the highest management level — they are not delegated to subordinates

Table 1 *Problems caused by poor location*

Problem	Possible cause
High fixed and variable costs	• Expensive site costs e.g. city centre location • High transport costs e.g. distance from raw materials or market • Wage rates above average e.g. as a result of very low regional unemployment
Falling sales revenue	• Lack of customer access • Declining tourist numbers in that area • Location may lack image and prestige yet these are important to the market
Recruitment of staff very difficult	• Low unemployment area may limit staff available • Areas containing few people with good labour skills will reduce numbers of suitably qualified staff
Efficient production methods cannot be easily adopted	• A planned switch from batch to flow production may be impossible if existing site is unsuitable • Distance from major component suppliers may make JIT an unwise strategy
No government grants or other assistance	• Governments in most countries offer businesses incentives in 'development zones'

When are location decisions necessary?

Location — or relocation decisions — may be necessary at different stages in the development and growth of a business. Some of the most likely situations are as follows:

- Newly formed businesses will have to consider where to set up their first premises. This is often close to the owner's area of residence as with the first Body Shop premises in Brighton.
- Expanding firms may need a new site to allow for growth or to set up a branch in a different location. Tesco is on the look out for more inner city locations for its small 'Metro' branches.
- Firms faced with uncompetitive costs may have to find a cheaper location. Prudential Insurance recently announced the closure of a UK call centre which is to be replaced by one in India.
- Businesses expanding abroad to become multinationals must select appropriate countries and locations within them. The mining giant Rio Tinto Zinc closed a gold mine in Bougainville and developed one in Lihir (both in Papua New Guinea) due to civil unrest in the former location.

What influences location decisions?

Many different factors influence location decisons. Their relative importance will vary greatly between different businesses and industrial activities. Consider these location issues that featured in the news in late 2002 — they all refer to different location factors.

> Jobs go in Czech move by Black and Decker due to lower **labour costs**
>
> Peugeot seeks **state grants** to keep Coventry plant open — other European sites are being considered
>
> Pizza Express says **sales** still falling especially in **London** branches hit by low tourist numbers. Expansion in other cities may be the best move
>
> Ford invests in truck plant in Canada after **deal with unions**

If you read the business section of a 'quality' paper regularly you will find many more examples like these.

Some textbooks make a distinction between the *quantitative* and *qualitative* factors that managers consider before choosing a new site.

Suitable new premises may have to be built when a firm relocates

Quantitative factors

Quantitative factors will have a direct impact on either costs or revenues and so, eventually, profits. They are measurable in financial terms. They include:

- **Site and capital costs** such as fitting out a shop. These vary greatly from region to region. Also, there are substantial variations within any one area, for example between a prime high-street location and small suburban shopping arcade.
- **Labour costs.** These can vary from region to region, partly influenced by local unemployment rates. Even greater variations occur internationally. According to *The Times* (6 October 2002) average labour costs per hour are $15 in the UK, $2.06 in the Czech republic and only $0.53 in China! The reasoning behind the closure of a UK Sanyo plant at the same time as the firm expanded its workforce in China by 315 can be easily understood.
- **Transport costs.** Materials and components may need to be shipped in and finished products may need to be distributed long distances. Therefore, the nearness of component/service providers and the major markets may be very important factors.
- **Nearness to suppliers** may also determine whether a manufacturing firm is able to apply JIT stock management. If distance and transport problems make this difficult then this will add further to costs.
- **Sales revenue** may depend directly on location. Confectionery shops and convenience stores have to be just that — convenient to potential customers. Petrol stations will generally sell most fuel if located on busy roads. But are there too many competitors in the same area?
- **When location adds to status and image**, especially with service providers such as private medical consultants or lawyers, then prices to be charged and revenue earned could be boosted considerably by locating at the most prestigious addresses, e.g. Harley Street, Lincoln's Inn. However, will site costs outweigh this advantage?

Quantitative data can be analysed using business studies techniques such as break-even analysis and investment appraisal, but because the results of these are likely to depend heavily on estimates, e.g. of future revenues from a location, they must be used with caution.

Before taking a location decision on quantitative grounds alone the accuracy of the data and the sources used need to be studied with care. In addition, qualitative factors cannot be ignored. For smaller firms, in particular, these can assume greater importance than the chance of earning an even higher profit.

Qualitative factors

Qualitative factors are not measurable but they could be just as important to the final decision. They include:

Table 2 *Issues to consider when answering case-study questions on location*

Issue	Reason for importance
Is it a service or manufacturing business?	Service firms must have easy access to consumers. Manufacturers may be more concerned with suppliers or special site requirements.
Is it a small (new?) business or a large one?	A small business may not be able to afford the 'best' location so may have to balance factors other than site costs when making the decision. However, a cheap location may be a false economy if there are few consumers nearby.
Is it labour or land intensive?	If labour costs are a high proportion of total costs then a cheap wage cost country might be considered. A large warehouse covering many square metres will not be located in city centres.
How are the goods distributed?	A recent A-level question concerned a computer company selling over the internet. Many answers focused on the need to be 'close to customers for their convenience'! However, a good infrastructure would have been significant to allow for efficient dispatch to all corners of the world. Put your answer into the context of the case study.

- **Disruption caused by relocation**, especially for senior managers. Employees may also resent the idea of moving to a 'cheaper' area if the quality of housing, schools and other services for their families is lower than the present area. Quality of life is difficult to measure or compare quantitatively — but there is no doubt that it does vary between areas and may influence managers' decisions. This can often contribute to 'industrial inertia' — the inconvenience of moving cancels out any cost benefits from relocation.
- **Planning/environmental restrictions.** The difficulty of obtaining planning permission and the risks of damaging important natural environments may make a firm look elsewhere, perhaps overseas, if it is considered that these issues will be less of a constraint on location decisions in other areas.
- **Transport links.** The quality of local infrastructure and the proximity to other firms in the same industry will have considerable importance to many firms — the huge increase in commercial land rents near the newly expanded Stansted airport support this. Just as important can be the issue of 'clustering' with other firms in the same industry. The clustering of many high-technology and bio-tech firms around Cambridge means that support services and supplies of skilled scientists and other staff are a key advantage to all firms in this sector.

Location in other countries

Multinationals are companies that own or control production or service facilities in more than one country. It is estimated that there are over 50,000 multinational companies. They increasingly dominate world trade and employment. In the UK, multinationals employ 11% of all workers and account for 30% of GDP. What factors cause these companies to locate abroad? They are driven by one of two main motives:

(1) Cost-oriented location decisions. These firms are attempting to reduce costs of production with their overseas businesses. So BP finds it cheaper to exploit oil resources in Azerbaijan than to further develop oil wells in the UK. Dyson will pay its new Malaysian workers one quarter of the wages of its former workers in Swindon.

(2) Market-oriented location decisions. These companies are mainly concerned with easier access to overseas markets. Either they intend to produce the goods abroad or they will import them from the 'home' country. Honda produces cars in the UK to gain access to the huge EU market without the trade barriers imposed on cars made in Japan. Nestlé generates 93% of its revenue from foreign markets. Its home market, Switzerland, is very small. It is also cheaper to produce chocolate in say, Asian countries, than to export this low-value product from Europe to other parts of the world. Other companies become multinationals to extend the product life cycle of their products, which could have hit the maturity stage of the home market. A product can easily be in different stages of its life cycle in different geographical markets. McDonald's sales in the US are virtually static, but are still booming in Moscow.

Other considerations

- Language factors — the UK is a popular location for US multinationals due to the common language.
- Exchange rate factors — an overvalued pound contributed to the closure of a tractor plant in the UK and the expansion of one in Italy. A high sterling exchange rate makes UK exports seem uncompetitive.
- Political stability — most companies will avoid locating in the world's major trouble spots.

A-level location questions

These are usually based on a case study. They may ask you to discuss whether the firm should relocate or the important factors that could determine where to site a new branch. Table 2 lists some of the factors about the business in a case study that you should consider before writing your answer.

You are advised to learn the main locational factors and their importance. However, you should *not* just reproduce all of your class notes on this topic without considering the nature of the case-study business and its products. Remember how many marks are available for *application* and relevant *evaluation*. Location decision questions give you an excellent opportunity to demonstrate your skills in both these areas.

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Discussion points

Why would it be much more difficult to reverse a location decision for an oil refinery than for a restaurant?

Discuss whether a manufacturing business should always relocate to where short-term government location grants are available.

How could the revenue potential of a car showroom be affected by its location?

Assuming no other differences, what would happen to the breakeven sales level if a shop moved to a cheaper site? Explain your answer.

Why might Dyson's UK factory managers object to relocating to Malaysia?