Urban Land Institute

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ULI Roundtable
Who decides the future of retail?

The following article covers the highlights of a forum of 19 leading European retail real estate professionals, held on 27th February 2014. It took place in the London offices of CBRE Global Investors, which generously sponsored and hosted the event, and kicked off the debate with an overview of its E-RISC tool, which assesses the impact of e-commerce on shopping centre assets. The objective of the forum was to explore the impact of e-commerce and multi-channel retailing on developers, owners and retailers, and identify the role of each in shaping this new retail landscape.

CBRE GLOBAL INVESTORS

Overview

A retail revolution has been underway over the last five years, and there isn't a shopping centre, high street or retail park that's immune from the rise of the online consumer. Today, investors and brands are not only focussing on how to survive it, but on how to win.

While retailers' growing appetite for omni-channel strategies - integrated technology systems that support physical, online and mobile routes to sale - poses a threat to bricks & mortar, it creates potential for a nuanced environment too, with fresh opportunities for brands and landlords alike.

Omni-channel retail might challenge the size and shape of lease requirements and encourage focus on dominant survivor centres, but real estate does offer brands important value and marketing creation opportunities.

This, the forum concluded, won't be achieved without innovation and partnership; helping brands define what they need from the physical environment. And while stores become crucial marketing opportunities, a new way of assessing the value of bricks & mortar is necessary.

As participants concluded, price per square metre is now a fully outmoded approach.

Retailers fight back

Retailers are now fighting back against the growth of pure online brands. And retailers, especially in the UK, are experimenting with new online channels, implementing strategies that provide consumers with a range of shopping options.

Happily these strategies include bricks & mortar, with some brands allowing consumers to buy through a tablet or phone while they're in store. Electronics brands for instance - which have been suffering from price competition sites - are now creating special products for sale that can only be purchased in special stores.

Physical retailers will push further expansion of the online market, everyone agreed. As one participant said: *"Online sales growth is coming from physical retailers. That's expected to continue as those retailers experiment on how to give customers a seamless omni-channel experience, and make a profit out of it."*

This is all taking place against a backdrop of uneven growth in online shopping, making it difficult to predict where threats to bricks & mortar still exist. Participants advised that while Europe's e-commerce market is expanding fast, its penetration rate differs from country to country.

The UK is the biggest online retail market, with cut-price digital music and video stores luring sales from physical retail in greater numbers each year: 80% of all sales took place online in 2013 (Verdict/SAS). The UK, along with France and Germany, represents over 60% of the European e-commerce sector.

Surviving e-commerce

For retail investors, keeping close to where brands are in this progression to omni-channel retailing is crucial; participants advised assessing tenants in a portfolio in these terms to understand how risky they are. Equally, retailers no longer see bricks & mortar as a way to grow their businesses like they used to.

But of key importance for retail owners when analysing brands in their portfolios is that this is by no means a uniform trend.

Some types of retailer remain suited to a physical store because consumers like to touch and feel their products before they buy - health and beauty retailers fall into this category. Food is also currently more compatible with the physical store model.

However, investors should also remember that while some sectors still only account for a small proportion of sales online, that could change. *"For those sectors where there's still a lot of room to grow there's still a huge threat to bricks and mortar".*

Participants forecast that fashion was one such sector to watch, despite the fact online sales accounted for just 14% of all UK clothing sales in 2013 (Verdict/SAS). *"As retailers get better at technology and people feel more confident buying clothes online, customers will increasingly use the internet for those purchases."*

Prudent risk analysis of tenants also involves assessing business models, as outlined in CBRE Global Investors' E-RISC tool. Participants found that retailers successfully adapting to the internet age had a specific "integrated" structure in common.

This comprises brands (like H&M and Zara) that produce and sell their own goods, and only distribute them in their own outlets. This "winning" business model is down to the fact they do not face price competition from online retailers.

By contrast, multi-brand retailers that offer a broad range of products sourced from different companies are at more risk from e-commerce. As one participant explained: *"Where consumers can find their products elsewhere at better prices, and with very little protection against price competition from online and other retailers, that retailer is more vulnerable."*

Exploring how savvy a brand's management structure is in relation to omni-channel retailing will also guide owners as to whether it has the right tenants in a portfolio. Retailers, predicted participants, are likely to undergo major changes in personnel functions to support the operation of an omni-channel brand. This is a task many haven't yet embraced.

Omni-channel profitability

The current lack of obvious capital returns from omni-channel retailing is not deterring brands from embracing it. But while many retailers appear confident that multi-channel platforms will be more profitable than single channel retail, achieving that profitability will be a long process.

The costs of sophisticated distribution networks and of making it "super easy" to buy online is pressurising retail margins, as are the costs of allowing customers to return items for free. And much more investment will be needed as retailers experiment with what format works best.

But brands have little choice but to embrace omni-channel retailing and begin the process of merging their physical and digital offers. In most cases they will be doing so without being sure of the right way to do this.

"Profitability isn't retailers' main concern. They want their customers to be happy with the offer and retailers know that if that's not the case, they're in serious jeopardy – especially if they plan to grow globally".

Given this investment involved, it's only the top brands that are fully embracing omni-channel retail today. Participants reported that the biggest brands in their portfolios gave consumers the choice of a website, web-shop, next day delivery service, click and collect and mobile apps. These brands are also using social media to advertise. Those just offering a web shop and website still comprise the majority of tenants.

Retail owners play a vital "advisory" role in shaping how brands balance their offer, and whom they target. Participants, agreed landlords, remained vital in providing retailers with information about consumers, and that they needed this data in larger amounts than ever before. *"A shopping centre owner knows everything about the people who visit and can provide brands with data they don't have. Retailers want to hear from owners about what's happening. That should be leveraged correctly."*

New role for bricks & mortar

Retailers are exploring how physical stores fit into this multi-channel offer, and best address changing consumer needs.

As brands grow their online share, retail owners are advised to help these businesses redefine what their physical shops could offer as part of new omni-channel strategies.

Brands are looking to create destination stores. And landlords must help tenants experiment with how they can make a physical shop part of the multi-channel experience.

Click and collect strategies, which are becoming evermore important to retailers, are an area of focus for owners given one in four customers buys in store during a trip to collect.

As one said: *"What retailers deliver depends on owners as orchestrators; where each brand is an instrument. How you combine those together could create beautiful music or a nasty cacophony."*

In-store service and experience is another way physical shops could distinguish themselves from the web. But participants warned that pure online operators would catch up, adapting their business to offer more than just transaction value.

AO.com, the online domestic appliance business, was used as a case in point: *"Physical retail has been about service, while the web was more transactional."*

"Now you have a company that can deliver and install a new washing machine just hours after you order it. If online players begin providing sophisticated levels of service, it challenges the bricks & mortar to be even more compelling."

Retailers will need to work hard to retain their edge on service, with manufacturers, online players and consumers often knowing more about the product than the salesperson in store.

The provision of convenience is still a crucial component of a retail offer however, with reports of strong performance by shopping centres anchored by hypermarkets.

Distinguished formats

Successful shopping centre formats of the future will be destination malls: offering experiences to draw footfall rather than a collection of anchor stores – as seen today.

This could extend to developers creating places to meet and socialise that also provide opportunity to buy products as a side offer. Participants predicted shopping centres could soon be thought of as "experience" or "gathering" centres, with their major function to provide meeting places that allow interaction – especially since the ease of online shopping creates more time for recreation.

Though it's an evolution that retail owners are familiar with, participants say it's hard to find interesting concepts that help give new developments this "experiential" edge.

Participants reported that there aren't many brands that provide an innovative array of activities or "experiences", with options today limited to food, cinema and bowling concepts. One participant said his business had funded brands to help create interesting experiences to secure footfall.

Some foresaw that keeping those experiences offered relevant and interesting to consumers would be costly as they quickly tired of them. *"It's important to determine what kind of experience people may want over a long period of time. Sometimes you need to build in the experience and sit and pray."*

Retailers will also come to value certain pitches as essential marketing opportunities, which will require a different approach to costing rents.

Retail investors with flagship pitches are in an excellent position to help offer what brands need from a physical environment in an omni-channel approach.

Investing in dominant shopping locations is key today but size isn't everything. *"A dominant centre could be a neighbourhood centre which has large footfall because it allows people to do what they need to do on a daily basis,"* said one.

Accounting for taste

Despite opportunities for landlord innovation, where customers will ultimately make their purchases – online or offline – will ultimately decide whether retailers can afford the bricks & mortar being offered by the real estate industry. *"This is the central unknown that is difficult for anyone to predict,"* as one participant said.

Others confirmed seeing square metre requirements reducing, as well as the required number of stores per country. *"Retailers will make less money and have less need for space and where they take space, they'll have less capacity to pay rent."*

To survive, global platforms will be necessary to cope with the costs and complexity of retailing in an internet age.

Offering experiences, distribution and exceptional service will be a costly exercise, a new economics of retailing that all but the largest global brands will struggle to support.

New metrics

A new approach to calculating value may be necessary as the role of bricks & mortar changes. Analysing value in terms of square metres is now an outdated metric for retail owners, argued participants. One said: *"The only thing that drives value is how many people come and what they spend."*

Participants also questioned whether thinking in terms of effort rates and cost of sale ratios was equally outmoded, reporting that some retailers are "taking a view" on effort rates as the physical stores help promote sales online.

Retail owners need to respond with a different leasing model and introduce shorter leases while the internet continues to favour the stronger brands.

"The consumer is driving the longevity of the brands, and you don't want to be faced with a retailer who hasn't kept up with what the consumer wants. Either consider a pop-up store environment or go for very short leases."

Like retail brands, retail owners need to continually invest in keeping pace with the changes underway. Owners face tough choices about which assets to invest capital in.

The key to placing capital expenditure sensibly was having detailed knowledge of the catchment area, understanding the demographics and economics that support a centre's trade potential.

But as retailers evolve their e-commerce businesses, partnering with brands to support them financially is a wise move. This strategy would be crucial in helping independent brands into a shopping centre; a must if an owner is seeking to bring an authentic, local feel to a shopping centre.

"If you want a retailer in a centre but know they're struggling, try and work with them. There will be increased opportunities to partner with brands in this way," said one participant.

Attendees

Marije Braam-Mesken	Senior Analyst Retail, CBRE Global Investors
James Brown	Head of EMEA Retail Research & Consulting, JLL
Colin Campbell	Non-Executive Director, Pradera Europe
Mark Dailey	Partner, Madano Partnership
Jan De Kreij	Principal, DKR Advisors
Joseph De Leo	Senior Partner, Benson Elliot Capital Management
Sylvie Freund Pickavance	Business Director, Bicester Village
Gerard Groener	CEO, Corio
John Herbert	Global Head of Real Estate & Hospitality, HSBC
Chris Igwe	Head of Retail, France & Senior Director EMEA, CBRE
Sheila King	New Business Leasing Director, Hammerson UK
Johannes Koeth	Head of Asset Management, SES Spar European Shopping Centers
Aref Lahham	Managing Director, Orion Capital Managers
Scott Malkin	Chairman, S D Malkin Properties and Value Retail
Brian Moran	Managing Director, Hines Ireland
Charles Pridgeon	Chief Investment Officer, Allianz Real Estate
James Raynor	CEO, Grosvenor
Will Rowson	CIO, CBRE Global Investors
William Sebring	Partner, Managing Director BV Altoon Partners
Jos Short	Executive Chairman, Internos Real Investors

Sponsoring Organisation

CBRE GLOBAL INVESTORS

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The EMEA platform, with €25.6 billion of assets under management, is one of the largest and most diversified real estate investment management businesses. This includes €12.7 billion of retail assets under management, which makes the company the largest private manager of retail in Continental Europe. It has 790 retail assets including 100 shopping centres and over 7,500 retail tenants.

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The Urban Land Institute

The Urban Land Institute is a nonprofit research and education organisation representing the entire spectrum of real estate development and investment. ULI was founded in 1936, and now has circa 30,000 members in 95 countries worldwide. In Europe, we have over 2,000 members supported by staff in London and Frankfurt.

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The success of the Product Councils relies on the active participation of our senior executive full members. If you would like to share your expertise and be involved in shaping the future of real estate in Europe, please contact Aymar Pirzada at **aymar.pirzada@uli.org** for information on applying to join a Council.

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