LANDLORDS, TENANTS AND E-COMMERCE

Will the Retail Industry Change Significantly?

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Overview

Internet sales of goods were approximately $170 billion in 1999 and are expected to increase rapidly. Predictions about the impact of e-commerce on retailers change just as rapidly. No study to date has analyzed the impact the Internet might have on individual retailers and their plans for expansion. This study provides an empirical baseline from which to track changes. On-site interviews of tenants at four types of retail locations revealed that unique products, high levels of service and closeness to the customer are important retailer strategies. Further, only a small number of retailers expect Internet sales to have a negative impact on their need for retail space.

■ Introduction

Firms selling over the Internet generated over $500 billion in revenues in 1999, representing about 6% of GDP in the United States and a growth

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rate of over 100% per year since 1993. Out of the $500 billion in total revenues, the sale of goods over the Internet was estimated to be $170 billion (Center for Research in Electronic Commerce, 1999). Year-to-date e-commerce sales are estimated to be $25.9 billion (Mahoney, 2000). Business-to-consumer (B-2-C) activity is expected to increase to $184 billion by 2003, while business-to-business (B-2-B) e-commerce is expected to grow to $3 trillion (*The Economist,* 2000).

A recent study of the world's 100 fastest growing companies by the London School of Economics (Smithson, 2000) found that firm size does matter when it comes to success on the Internet. Smithson found that the world's largest, best-established "bricks-and-mortar" organizations are better e-business performers than startup dot.com firms. Although this may be an obvious finding, it is important since many experts over the last few years have predicted that startup e-tailers, such as Amazon.com, would be taking over the retail industry.

It is largely thought that B-2-C sales will primarily suit products that are standardized and that do not require extensive customer service, e.g., books, CDs, videos (Borsuk, 2000). This is supported by recent online buying behavior. Online consumer sales in 1999 were primarily in three areas: travel (32%), computers (31%) and books (9%). Gifts/flowers (4%), music and apparel (each with 3%) and entertainment and food (each with 2%) accounted for the next 14%. The "other" category, the remaining 14%, covered a variety of merchandise, none of which comprised more than 2% of the overall total; for example, toys made up only 1% of the 1999 sales (ICSC, 2000). Most of these products tend to be standardized and require minimal customer service.

Therefore, some observers have argued that bricks-and-mortar retailers will need to specialize in unique, differentiated products and high levels of customer service in order to vie with online competitors. Yet, even in terms of customer service, it is not clear that bricks-and-mortar retailers have an advantage over e-retailers. Lands' End, for example, has capitalized on features of Internet technology by building an elaborate Web site with "fitting" capabilities, thereby offering individual customization. Recently, it has added a "live person" to its services for people who want to shop on the Web and talk to customer service at the same time. These new approaches have been labeled "clicks-and-mortar" (Gladwell, 1999).

No clear winner among the multiple e-commerce models has emerged (Grover, 1999), with the exception of firms that have spent large sums to take an existing concept and "put it online" (Smithson, 2000). During the 1999 holiday season, there was a shift in power from "pure-play" e-tailers to traditional retailer Websites. In 1999, the top 50 Web sites were dominated by such well-known firms as Barnes & Noble, Gap and Victoria's Secret (Pangia, 2000). According to Standard and Poors' Industry Reports (1998), consumers shop not only for the lowest price, but also for entertainment value. This is an important existing attribute for shopping center owners and traditional retailers. For the traditional bricks-and-mortar retailers, strategies such as store design, user-friendly atmosphere and merchandise mix will be increasingly important in attracting foot traffic and sales.

In response to increased consumer use of the Internet for shopping, retailers need to consider their existing and future strategies. First, they should consider whether or not they need to adopt an Internet selling strategy. Second, regardless of their Internet strategy, retailers seeking to maintain a physical location will need to develop strategies that offset the potential loss of store traffic to and consumer purchases from competitors who are using the Internet. Third, if they do incorporate an Internet strategy, they will need to create policies regarding the relationship of Internet sales to individual stores. For example, for the large national or regional chain, will local stores be credited with some or all of Internet sales made by customers in the store's geographic region?

No matter what strategies the traditional retailer adopts, shopping center owners could also be affected and should develop their own competitive strategies to maintain acceptable occupancy levels and rental income streams (Baen, 2000). Otherwise, they run the risk of losing percentage rental income and in turn value in their investments. Miller (2000) estimates that the impact of retailer Web use in the next five years could amount to a 25% reduction in total base and percentage rents collected by the shopping center owner.

To date, very little research has been done to measure the impact of the Internet on the retailers' business and hence the potential impact on shopping center value. The purpose of this research is to assess the existing strategies as well as the future plans of retailers and their use of the Internet as an alternative distribution outlet. It is the first study to examine the demand for retail space, asking the tenants how they see the Internet impacting their business. To this end, the study surveyed retailers located in Fort Collins, Colorado, in late 1999.

■ Literature Review

There are basically three strategic responses to the Internet as an alternative distribution system: remain as a physical location, switch to a cyberspace location or utilize a combination of physical and cyber locations (Hendershott, Hendershott and Hendershott, 2000). The choice of strategy depends in large part on the retailer's merchandise/service offerings and the clientele served. Physical locations are likely to remain the primary distribution outlet for services or products that require high levels of service. Cyber locations are likely to be used for repeat purchase, merchandise that is standardized or has high brand awareness (Armstrong, 1999). Online-only businesses (Amazon, for example) showed tremendous promise in recent years but they have recently suffered compared to the performance of traditional retailers. The most successful users of the Internet to date appear to be large established companies that have developed a bricks-and-click strategy (Smithson, 2000).

Although little research has been done on the impact of the Internet on retailers and the shopping center industry (Baen, 1999; and Miller, 2000), a rich literature exists of previous studies on the location strategies of traditional retailers. Historically, retail location decisions were based on one, or a combination, of the following factors (Vandell and Carter, 1993; Eppli and Shilling, 1996): convenience (locating close to the consumer); clustering (locating near competitors, which allows for comparison shopping); demand externalities (locating near anchor tenants); and saturation (locating in areas away from those overcrowded with competitors). Eppli (1998) recently argued that consumers shop at regional centers for three reasons: location, comparison-shopping and store fashion.

In the future, retail location decisions may be different because of a retailer's Internet strategy, First, the Internet provides convenience (available 24/7) and the ability to comparison shop. Second, clustering and demand externalities will be less important as consumers can comparison shop at multiple Web sites. This is becoming even easier as portals are being developed with multiple retailers all connected. Finally, saturation in a particular location may become irrelevant because of the ability to tap into a worldwide market. This leaves store fashion and customer sales advice/service as the reasons consumers are attracted to regional shopping centers. As Smith (1999) notes, a customer will want to try on a $1,000 designer outfit or at least have the type of relationship with the store and its staff to trust that they will follow up if the customer is dissatisfied.

Based on observations and current trends, it appears that a retailer's Internet strategy is likely to depend on its merchandise/service offerings, its perception of competitive threats and its familiarity with or confidence in using the Internet. In turn, these factors may affect the retailer's demand for store space.

■ Research Methodology and Data Analysis

This research was conducted as a class project in order to integrate emerging trends about e-commerce into class content as well as to involve students in the research process. Students in three different upper division business classes conducted interviews of retailers in Fort Collins, Colorado.[1] Located in the front range of Colorado about an hour north of Denver, Fort Collins is a rapidly growing city with a population of slightly over 100,000 people.[2]

Teams of two students were responsible for doing background research on each retailer's Web page (i.e., did one exist and what was its function), conducting an interview with two different retailers and summarizing the findings in a short paper. The tenant sample was assembled by sending a letter to 276 retailers obtained from a local real estate broker, an association of downtown merchants and the owner of the local regional mall. The letter explained the class project and asked for the retailer's participation. Follow-up calls were made to 206 retailers to determine their willingness to participate in the project. A total of 97 retailers agreed to be interviewed during the Fall semester of 1999, resulting in a response rate of 35% for the letter recipients (47% for those contacted by the follow-up phone call). Students reported that most of the interviews took between 15 and 30 minutes, although some students had in-depth conversations with their respondents lasting over an hour.[3]

Tenants at four basic types of retail locations were surveyed. As indicated in Exhibit 1, respondents came from all four of the major types of retail centers. Additionally, the sample can be divided across the specific types of retailers. As illustrated in Exhibit 2, the most common respondents were the independent retailers (66%), followed by national or anchor tenants (14%), franchises (8%) and regional tenants (6%). As illustrated in Exhibit 3, the respondents were also relatively smaller tenants with over half of the retailers (52%) having less than $1 million in sales in 1998.

To determine the classification of the retail respondent we used the major classifications found in the *Trade Dimension 2000 Retail Tenant Database*. As illustrated in Exhibit 4, the largest classification of respondent was for retailers that sell home products (28%), followed by retailers that sold lifestyle products (18%), and retailers that sold apparel and accessories (17%).

Variables studied included factors impacting merchandising strategies, locational decisions and sales generation. Additionally, respondents were asked about their perceptions of competition and the impact the Internet would have on their business. Finally, questions were targeted toward the retailer's current Internet presence/capability as well as the firm's future Internet strategy and the impact of such a strategy on subsequent expansion and location decisions. For the most part, Likert scales were used asking respondents to rate their perceptions on a scale from 1 to 5, where 1 represented very unimportant and 5 represented very im-

Exhibit 1
Respondents by Type of Shopping Center

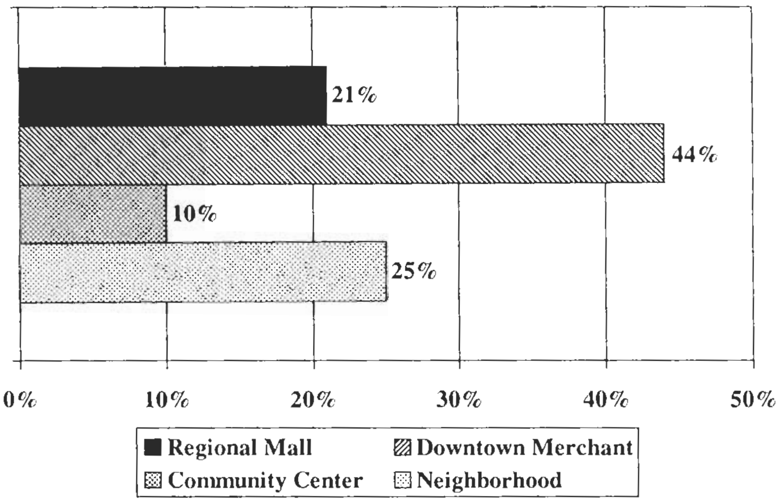
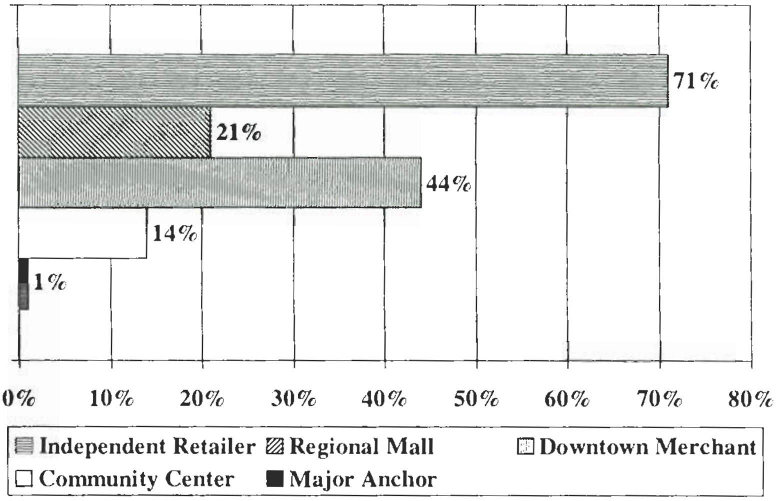


Exhibit 2
Respondents by Type of Retailer



portant.[4] In this section, the retailers' responses regarding merchandising strategy, factors impacting location decision, factors in generating sales, perception of competitive threat, Web page status and retail expansion plans are summarized.

Exhibit 3
Size of Respondents by Sales Volume

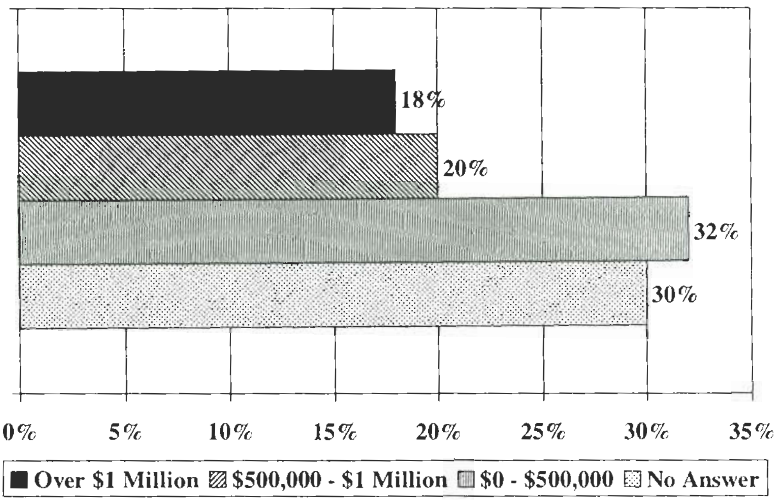
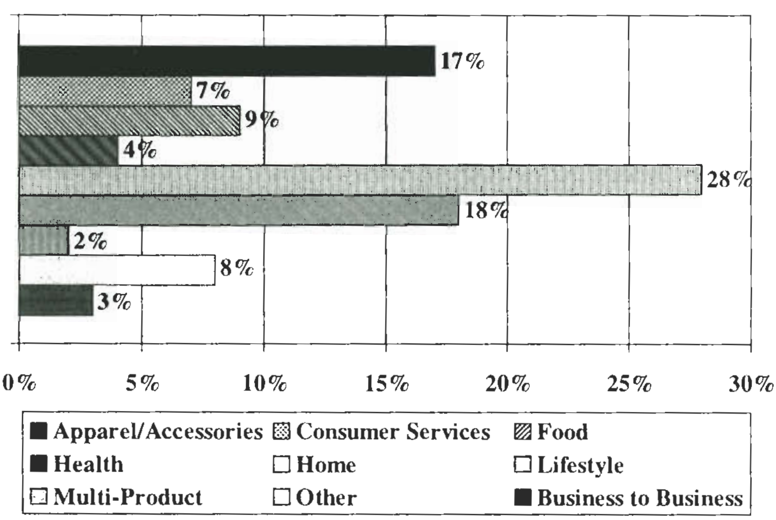


Exhibit 4
Classification of Retail Respondents



Merchandising Strategy

As indicated in Table 1, emphasizing customer service was the most important merchandising strategy with a mean rating of 4.89 on a five-point scale for these retailers. All but one of the respondents rated this factor as either important or very important in their merchandising strategy. Selling unique products was also important to the respondents with a mean rating of 4.32. There were, however, nine respondents who indicated that selling unique products was not an important merchandising factor. Selling standardized products and branded products were less important factors for the respondents with mean ratings of 3.28 and 3.89, respectively. In fact, close to one–fourth of the respondents indicated that a standardized product was not at all important to their merchandising strategy.

TABLE 1. FACTORS IMPORTANT IN RESPONDENTS' MERCHANDISING STRATEGY

	Respondents Rating 1 or 2*	Respondents Rating 3	Respondents Rating 4 or 5	Mean Rating
Unique Product	9	8	79	4.32
Standardized Product	25	24	48	3.28
Branded Products	17	12	68	3.89
Customer Service	0	1	95	4.89

Notes: Likert Scale where 1 = Very Unimportant and 5 = Very Important.

Location Decision

Retail literature typically cites all four factors listed in Table 2 as important for making a retail location decision. Respondents indicated that convenience or closeness to customer base was the most important factor affecting their location decision (mean rating of 4.09), followed by availability of parking (3.76). It is interesting that nearness to an anchor (2.57) and nearness to competitors (2.47) were rated as being relatively unimportant. It should be noted, however, that these factors were cited in previous research, which typically focuses on retailers that are located in regional malls. Just over 20% of the survey respondents were located in the regional mall. Results indicated that for the strip mall tenants and freestanding tenants these issues do not seem as important.

Factors in Generating Sales

As indicated in Table 3, service, product type, sales advice and user-friendly atmosphere were the four factors identified by the sample as being almost equally important in generating sales with relatively high mean ratings of 4.83, 4.58, 4.54 and 4.50, respectively. Service was most

TABLE 2. FACTORS IMPORTANT IN RESPONDENTS' LOCATION DECISION

	Respondents Rating 1 or 2	Respondents Rating 3	Respondents Rating 4 or 5	Mean Rating
Convenience	9	16	69	4.09
Competitors	45	29	20	2.47
Anchor Tenant	50	17	26	2.57
Parking	14	19	60	3.76

Notes: Likert Scale where 1 = Very Unimportant and 5 = Very Important.

frequently ranked as important or very important (94%) followed by atmosphere. All four of these factors are relatively difficult to recreate on a Website. Store design (mean rating of 4.05) was also rated as important, while foot traffic (3.72) and an e-commerce strategy (3.06) were less important but still above neutral in terms of generating sales. While e-commerce strategy was only slightly above neutral for the mean rating score, over one-third of the respondents felt this factor was an important or very important factor for them in terms of generating sales. This provides some initial evidence that the Internet has started to play a role in the business strategies of some retailers.

TABLE 3. FACTORS IMPORTANT FOR RESPONDENTS IN GENERATING SALES

	Respondents Rating 1 or 2	Respondents Rating 3	Respondents Rating 4 or 5	Mean Rating
Store Design	6	13	76	4.05
Atmosphere	3	4	89	4.50
Foot Traffic	17	18	61	3.72
Service	1	1	94	4.83
Sales Advice	4	5	86	4.54
Type of Products	1	9	85	4.58
E-commerce Strategy	28	28	38	3.06

Notes: Likert Scale where 1 = Very Unimportant and 5 = Very Important.

Perception of Competitive Threat from the Internet

Table 4 summarizes the retailer's perception of its competition. Their perception of the overall competition was that it posed between a neutral and significant threat (mean rating of 3.53). Given the responses to the merchandising, locational and sales generation questions, it is not surprising that their perception of the threat from Internet competition was lower, between neutral and minimal (2.49), with only 18 retailers rating Internet competition as a significant or very significant threat. Additionally, respondents also believed that they had lost very minimal to minimal foot traffic and sales to the Internet, with mean ratings of 1.71 and 1.72, respectively.

TABLE 4. PERCEIVED IMPACT OF THE INTERNET ON RESPONDENTS

	Respondents Rating 1 or 2	Respondents Rating 3	Respondents Rating 4 or 5	Mean Rating
Threat of Competition	23	15	58	3.53
Threat of Internet Competition	50	28	18	2.49
Lost Store Traffic	76	15	5	1.71
Lost Sales	78	16	3	1.72

Notes: Likert Scale where 1 = Very Minimal and 5 = Very Significant.

Web Page Status

With the use of the Internet still in its infancy, it is important to ascertain where respondents presently stand in regards to setting up a Web page and/or using it to conduct business. At the beginning of the interview process 43 retailers (44%) had a Web page, while 25 retailers (26%) had a Web page under construction. Most retailers indicated that they used their Web pages for informational or advertising purposes rather than sales transactions, although, almost a third of the retailers have generated sales over the Internet. As Exhibit 5 indicates, most of the retailers with Internet sales captured 5% or less of their gross 1998 sales from the Web. Seven retailers indicated that between 10 and 30% of their sales were done on the Internet, while one retailer reported as much as 60% of its sales were generated from the Web site. When asked how confident respondents were to sell their products over the Internet, the mean rating response was between neutral and confident (3.49). Yet, as indicated in Table 5, close to half of the retailers (45) were confident to very confident that they would be successful in selling over the Internet.

Retail Expansion Plans

A major question facing shopping center investors is what will be the likely impact of the Internet on the retailer's demand for space. Will

Exhibit 5
Percentage of Respondents Who Presently Have Sales from the Internet

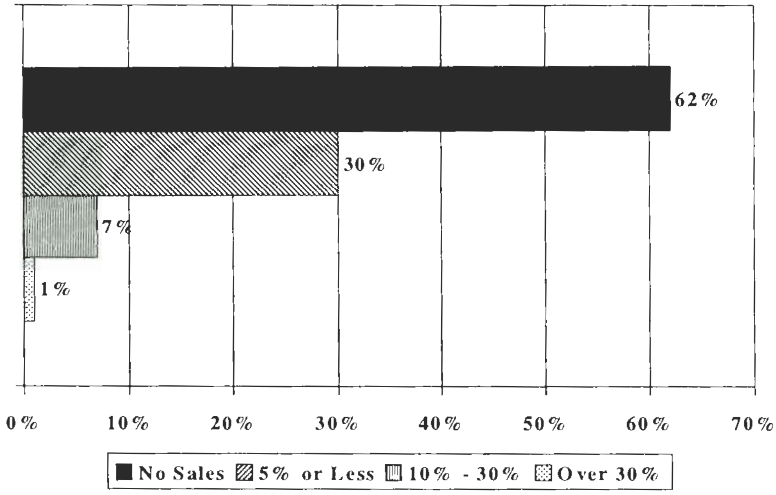


TABLE 5. RESPONDENTS' CONFIDENCE TO SELL THEIR PRODUCT OVER THE INTERNET

	Respondents Rating 1 or 2	Respondents Rating 3	Respondents Rating 4 or 5	Mean Rating
Sales over Internet	30	20	45	3.28

*Likert Scale where 1 = Not confident at all and 5 = Very Confident.

competition reduce the need for traditional bricks-and-mortar and/or will the bricks-and-click strategy allow retailers to reduce their demand for high cost "Main Street" locations and increase the demand for distributor/warehouse space? Most respondents believed that the Internet would have a very minimal to minimal impact on their need for retail space in the next year (mean rating of 1.65). There was a slight increase to minimal when retailers were asked to consider the impact of the Internet on their need for retail space over the next five years (mean rating of 2.16).

Leases

To ascertain whether or not the tenant leases have started to change due to the advent of the Internet and growth of e-commerce, respondents were also asked several questions about their leases. For the most part, respondents had conventional triple net leases and were responsible for utilities, insurance, taxes and common area maintenance. Similar to Baen (1999), only a few respondents (16%) had traditional percentage rents or overage charges. Finally, national, regional and franchise tenants were asked whether the corporate office had a policy for linking e-commerce sales generated in a geographic region to the sales levels of a given retail outlet. This question was answered by less than one-third of the respondents (29) and only 20% of these retailers indicated that this policy did exist within their organization.

Comments by the Respondents

As with most behavioral research, comments from individual participants often highlight some of the underlying reasons for their responses. In this instance, many of the comments focused on the perceived barriers to the use of the Internet for actual sales transactions. Many respondents indicated they would be using the Internet for advertising and product information rather than for true e-commerce or sales transactions. A few tenants also mentioned that clauses had been added to their distributor contracts to protect the sales for the individual retailer. However, these clauses do not appear to be common. In fact, numerous respondents voiced concern that, in the future, suppliers might actually go directly to the consumer leaving the retailer with a significant loss in sales volume. At the moment, most of the respondents indicated they had no protection from this type of competition. In particular, one respondent perceived the Internet to be a major competitive threat and since the survey was completed, this retailer has filed for bankruptcy.

■ Summary, Limitations and Areas for Future Research

Over the last few years there has been a large amount of popular press devoted to the growth of the Internet, creating hype that traditional retailers will vanish and shopping centers will need to reposition themselves or lose favor with the investment community. However, no one has taken the time to ask the retailers how they think the Internet will impact their present business and future expansion plans. This study sent students to the retailers to determine what, if anything, they were doing with regard to the Internet as well as their future plans for employing the Web as part of their merchandising strategy. Although the results are somewhat biased, due to the larger number of small, independent retailers in the sample, one preliminary conclusion can be drawn. Retailers of unique products or those relying on service were less likely to view the Internet as an important new channel of distribution. Those retailers selling standardized or branded goods were more concerned with the potential erosion of sales from the Internet and have taken a more aggressive Web-based selling strategy. In either case, however, few retailers felt the Internet would impact their need/demand for retail space in the next three to five years.

The majority of retailers responding to the survey were not successfully selling on the Internet at the time of the survey. In fact, many indicated that they would use the Internet solely for advertising and product information rather than e-commerce transactions. A smaller number of retailers indicated that they were taking the competitive threat seriously and were planning to do more business on the Internet in the near future. However, one thing is clear for the retailers in this study: unique products, high levels of service and closeness to the customer were all important strategies for the respondents. This profile would be consistent with a hybrid Internet strategy where customers buy online, but pick up their purchases and make returns at a local outlet (Hendershott, Hendershott and Hendershott, 2000).

The use of the Internet is still in its infancy. It is too early to predict whether or not retailers will reduce their need for traditional space and shopping center owners would therefore lose tenants and consequently value. It is possible that the bricks-and-mortar shopping experience will attract consumers and provide entertainment value and high levels of service as well as an Internet option. In this latter case, retailers would continue to demand retail space and a major change to the shopping center values would not occur, providing a relatively bright future for landlords. However, no matter what actually transpires, the data gathered in this study indicate retailer type is an important variable for Internet success. Additionally, all retail industry players need to stay informed on the benefits and pitfalls of e-commerce, as this new channel of distribution takes hold in the marketplace.

As a pilot study, this research focuses on retailers in Fort Collins. Therefore, national or regional tenants were not the majority of the respondents, although some of the largest U.S. retailers were part of the survey. Given these limitations, generalization of the results should be done with caution. Since large national chains are the typical tenants for most regional malls, the impact of the Internet on their sales and/or demand for space needs to be ascertained to obtain a clearer picture of the Internet's impact on regional shopping centers. Thus, it is essential to survey corporate executives who establish the e-commerce strategies for these retail outlets. Many of the national respondents of this study indicated they were not sure of the parent company's Internet strategies.

Finally, in such a rapidly changing environment, tracking the use of Web sites and e-commerce is similar to trying to hit a moving target. Many retailers in this study indicated they were in the process of launching Web sites. It was difficult to monitor the advances made by respondents. However, this research is a starting point. It is the first study that specifically focuses on retail space demand with the advent of the Internet. For the most part the common response was a minimal impact on demand for space, which should allow shopping center investors to breathe easier.

■ Notes

1. Courses used were Real Estate Principles, Entrepreneurship and New Venture Creation.
2. Although Fort Collins is not included in a recent ranking of metropolitan areas with a high concentration of computer users, Denver is ranked seventh (www.scarborough.com). Fort Collins' industry base is made up of such technology firms as Hewlett Packard, Advanced Energy and Celestica as well as a major research university. Thus it is likely to have a similar profile of computer usage to that of Denver.
3. Students were given an hour lecture and practice session on how to conduct personal interviews.
4. A copy of the survey is available on request.

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