# Economy Matters Insights and IMPACTS

## **Changing Times**

Opportunities abound—but retail must learn to adapt.

#### **By Andrew Nelson**

HE RETAIL SECTOR is changing. Again. Positioned at the crossroads of fashion, economics, demographics and geography, retail has always been the most dynamic of the property sectors. But the current transformation has been particularly swift and wide ranging. Technology has both enabled and encouraged new retailing business models at the same time that financial conditions have forced households to deleverage and rethink their shopping habits, changing how, where and how often they shop. This creates myriad challenges for the incumbent players stuck in old operating modes, as well as abundant opportunities for new and existing players bold enough to innovate.

No challenge is more significant than shoppers' embrace of digital products and e-commerce at the expense of physical products purchased in brickand-mortar stores. Households are also spending relatively less on retail goods and more on services, such as education, health care and housing.

Thus it is that the retail sector, unique among the major property sectors, is still struggling to regain its former strength, suffering highly elevated vacancies and lack of broad-based rent growth, even though economic recovery from the Great Recession is now virtually complete. With fewer goods and services being purchased in retail centers, the need for shopping center space is reduced. Our country was drowning in too much retail space even before the recession, and now e-commerce and shifting consumer-spending patterns

have rendered even more space unsupportable. More challenging still: Much of the existing stock of stores and retail centers is obsolete or at least outdated and in need of a refresh to meet changing consumer preferences.

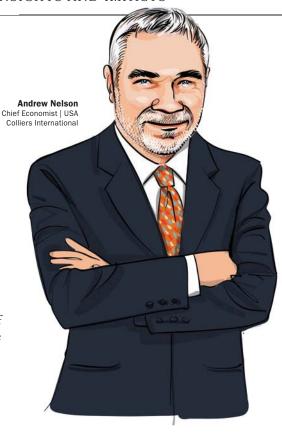
And yet, opportunities still abound for retailers and retail property owners that can adapt.

#### Variety Is the Spice of Life

The physical retailing world is finding it increasingly difficult to beat the Internet on price, selection and convenience. To succeed, retail centers must play to their natural strengths. They have long been centers of social interaction as well as commerce. While the Internet certainly offers virtual connection, true social interaction occurs in physical places. Successful shopping centers are now learning what vibrant urban retail districts have long known: Shoppers come for the goods and stay for the services.

Shopping centers are reducing the space devoted to traditional retail goods while increasing the amount and variety of experiential space: restaurants, entertainment venues, spas, fitness studios and coffeehouses and bars. In the right center, educational and medical uses also may make sense. And nontraditional food uses, such as food halls and specialty grocers, are entering retail centers and urban districts as never before.

The goal is to provide shoppers with a diverse set of reasons to come, shop, play and stay.



#### **Competing with E-commerce**

The vitality of dynamic shopping districts and malls extend right into the stores themselves. The most successful retailers are seamlessly blending the best aspects of digital and physical to deliver better experiences for shoppers and better economics for the stores. Retailers must deliver distinct and exciting new experiences. This might include bringing food uses right into the stores, much like traditional department stores; leveraging mobile technology to deliver customized offers to shoppers; and introducing new virtual technology into dressing rooms. Stores are experimenting with social events organized around shopping. We can anticipate many false starts along with the winning ideas, but relentless competition from online-only retailers demands that physical retailers keep pushing the boundaries.

All of these improvements cost money, of course, but done well, these investments can pay big dividends. Physical stores convert a much higher share of their visitors into paying customers compared to online retailers, and also encourage much more impulse shopping. These tendencies are



enhanced by the right in-store technology and strategies to keep customers shopping longer. Moreover, leading chains realize that omnichannel strategies are more than today's buzzy business jargon: physical retailers with effective online offerings outsell pure bricks-and-mortar stores, while online retailers can enhance their brand with strategic physical stores.

### **Changing Demographics** and **Geographies**

An old adage in retailing suggests that store locations "follow the rooftops." During the exuberance of the 1990s and early 2000s, however, developers and retailers alike got ahead of themselves, building and occupying retail space built in anticipation of a population base that never materialized. So we built a lot of unnecessary shopping centers and many chains overexpanded.

But the underlying premise still holds: Growing populations support more retail space. And here's the good news: Despite a slowdown during the recession and its immediate aftermath, the U.S. population is expanding by almost 1 percent annually. This is a distinct advantage over most other developed nations, which are seeing much slower growth or even declining populations. Our growth is both organic (babies) and imported (immigration). The net result is expanding markets for retailers. But not all regions are alike. The West and South are growing four times faster than the Northeast and Midwest and so offer much richer market potential.

More good news: Urban markets still represent a relatively underserved segment. While many chains and developers were overcommitting to saturated suburban markets, they failed to recognize that the rules were changing. Counting rooftops works well in growing suburban markets, but understates market potential in downtown areas increasingly preferred by many groups, but especially millennials. Urban retail presents unique challenges, namely available storefronts often don't fit the normal mold and are expensive. But the rewards are denser customer bases and more limited competition.

Our nation is growing differentially in

other ways, too. The white population is barely growing, while Hispanic and Asian populations are soaring. Single-person households are far outpacing traditional married-with-children households. All of which create opportunities and challenges for the retail sector.

#### **Final Thoughts**

Half a century ago, urban residents left cities to settle in suburbs, prompting the emergence of malls. Now, urban areas are growing again and suburbs are becoming more ethnically diverse. And technology is changing just about everything to do with how and where we shop. Retailers must adapt.

The process will be bumpy. Chains will close outmoded stores in nonstrategic locations at the same time they open stores in new locations following new prototypes. Formerly high-flying chains will disappear, replaced by new players with better ideas. Whole categories of retail goods migrate from brick-and-mortar stores to online retailers, and then the products themselves are digitized. One thing is for sure: No one gets to stand still.