

9

Retail 2020
The New Retail Rulebook

5 Key Lessons
from the Future



Real value in a changing world

Retail **2020**

The New Retail Rulebook: 5 Key Lessons from the Future

No time to be a frog

You will have heard the tale about the frog. Place a frog into warming water and it dies as the water heats up. Place a frog into hot water and it jumps out, saving its life. The trends highlighted by our Retail 2020 report are akin to rising water temperature; everyone feels the evolution but very few think it is worth reacting to.

In order to help the retail industry avoid the fatal trap of passivity, we have plunged into our Retail 2020 findings, published to great acclaim in 2010, to reveal the true impacts and implications of our ongoing trends research.

Our analysis has been shaped by numerous client and retail industry meetings held across EMEA over a 12 month period, a dozen expert interviews, online survey results, datamining – as well as a recent top table Think Tank.

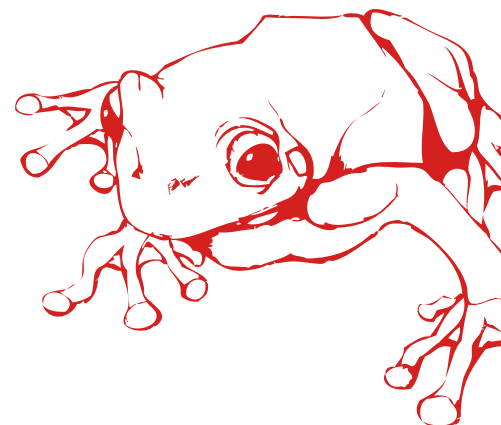
The result of our analysis has been stunning, even to ourselves. No doubt, several years will have to elapse until we can conduct a robust appraisal of the reports' foresights. Nevertheless, what we can say is that, for now, the trends highlighted a year or so ago are still actively driving the marketplace – and in the direction we forecast. Some trends are cyclical in nature; we believe that the trends we have identified, however, impact on the overall structure of the retail industry. The time has come to tear up the old rules and invent a new Retail Rulebook. The next decade needs new guidelines, new relationships, new talents, new tools.

This radical agenda forms the body of this latest chapter. Our '*5 Key Lessons from the Future*' explores and highlights many very practical consequences of the trends outlined in Retail 2020. There are numerous levers to pull and a new Retail Rulebook to follow:

1. Approach technology as a mindset, not merely a tool
2. Sustainability is a big risk, but also opportunity, for retail investors
3. Upskill, partner and diversify to survive
4. Get them and keep them
5. Quality (or true convenience) will out

Our Retail 2020 report was subtitled: Change is coming, are you ready?

With the addition of this latest chapter, we can now issue a more proactive challenge: Change is here, the water is bubbling - are you ready to jump?



Setting the scene: Don't waste a good recession

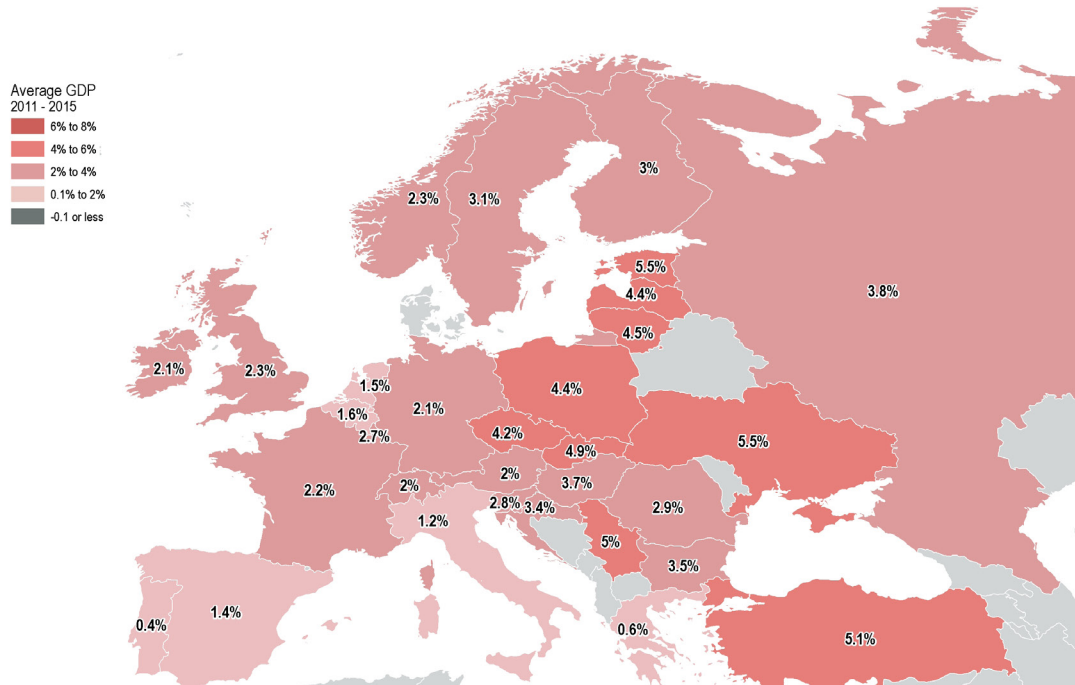
We start by exploring the current economic conditions, and in particular their impact on the retail industry. Whilst the stock market turned in March 2009, and we are supposedly in an 'economic recovery' phase, it is and will continue to be, one characterised by intense volatility.

The European consumer mood is fragile and spending is weak. Unemployment, the threat of losing your job, commodity inflation, debt restructuring, lack of credit – there is a lot out there which is reducing capacity, but above all, willingness to spend, despite record low interest rates. British insolvency trade body, R3, has called this “the worst squeeze in living standards for 40 years”. Waves of social and political unrest in Greece, Spain and the UK point to an icy social mood.

With so many sour consumers, some retailers, and by extension, retail landlords, have never really climbed out of recession. Looking ahead, even by just a few months, sees a number of retailers and landlords on their last legs. Every stock-building cycle or quarterly rent demand drives struggling retailers closer to – or over - the edge. Meanwhile, landlords' patience in keeping retailers from insolvency is being stretched to the limits. And how near are some landlords themselves to the precipice – when banks need to guarantee their loan book and meet new 'stress test' capital requirements?

Every stock-building cycle or quarterly rent demand drives struggling retailers closer to – or over - the edge. Meanwhile, landlords' patience in keeping retailers from insolvency is being stretched to the limits.

Average European GDP Growth Forecasts, 2011-2015 (% average per annum)



Source: IHS Global Insight

But even those players able to see beyond the immediate future will struggle in the face of a strengthening consumer and public debt squeeze. Interest rate rises (in the medium term) will increase the cost of borrowing for many consumers – especially those with mortgages. Meanwhile, upcoming European government austerity measures will slash the public sector and, surely, result in tax increases. The bond markets will drive this logic even further than most politicians can imagine. Political and social unrest is guaranteed. The Euro will wobble. Sovereign debt will default.

Looking across the EU27, the outlook for economic growth to 2015 appears bleak- but there are big national disparities, as illustrated above.

The outlook for economic growth to 2015 appears bleak- but there are big national disparities.

The upshot for the retail industry is that the perfect storm will remain overhead for some years to come and that GDP growth will be at 'new normal' rates – 1.5-2.5% rather than 3-4%.

If the economic impacts are on flatter spending, lower sales and pressure on rents, what are the actions for the industry?

Rejuvenate:

Don't waste a good recession implies taking the opportunity radically to reposition, rebrand, and reconfigure the business. This doesn't just mean cost cutting. We can expect to see some new business models develop and some innovative turnaround situations. Expect too, a ramping up of small entrepreneurial retail businesses as the economy starts to bottom.

Efficiency:

Further effort will be needed to manage the retail estate more efficiently. Partly it's about right-sizing. Some retailers are upsizing and will continue to do so. Most struggling retailers, however have been managing real estate downwards in the recession. As the gloom continues, the question will change from: "how much space do we need to lose to keep the business stable?" to "how low can we go?". This implies realigning the channel strategy to the new realities of internet potentials. It will also mean retailers seeking to balance their portfolios better internationally. Partly, efficiency will come from sweating assets - the stores that remain will have to work harder. Finally, greater efficiency is also about fully understanding the property fundamentals. To this end, location specific due diligence will become increasingly important over the next decade.

Upskill:

Within a few years, we have moved from a workplace of efficiently functioning job servers, to a market where service and knowledge workers make or break businesses. This isn't just top talent, but a new breed of worker capable of taking risks, innovating, being wrong, making connections, working across silos.

Opportunities:

Where cash is king, those with strong cash-flows and balance sheets are going to be the most active in the years ahead either through mergers and acquisitions (M&A) or accelerated organic growth. Superdry, Hollister, Apple, Crate & Barrel, Victoria's Secrets and Forever 21 are all on the organic expansion trail in Europe. Meanwhile in M&A, some retailers are keeping their powder dry for now, waiting for even greater bargains ahead.

**The wider economy
- and the retail
industry specifically
- is facing huge
headwinds. The
new secular forces
are new and nasty
- at least for the
weakest players and
those who are least
prepared.**

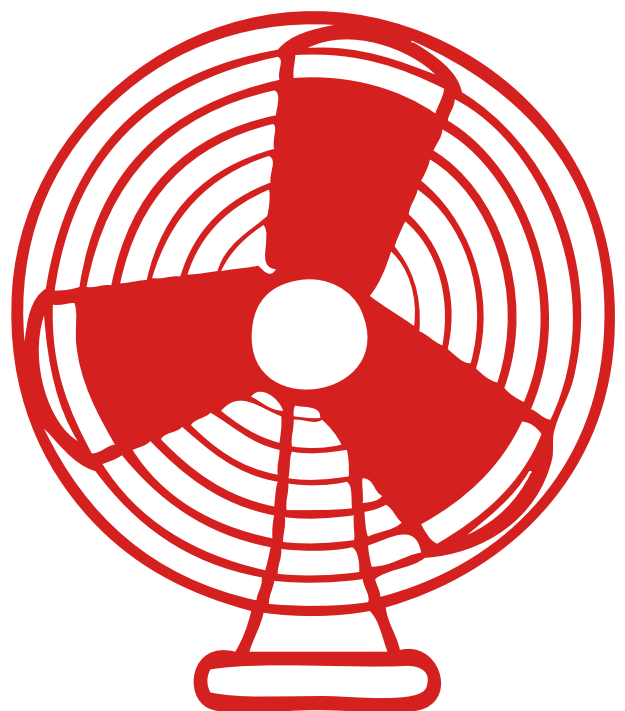
Flexibility:

The old rule book was concerned with long leases and strong retail covenants. Recently, shopping centre landlords, whilst not having to 'take anything', have certainly had to demonstrate more flexibility. Is this mere pragmatism or a paradigm shift? Pop-ups, for example, are becoming a convincing alternative format, offering high streets and shopping centres alike a perfect way to innovate, bring in manufacturers' brands and tap into latent consumer spending. They are here to stay. Clearly the pendulum *will* swing back towards the landlords according to the cycle and individual market conditions, but the question is, *how far* will it swing back?

In summary, those expecting the cycle to turn anytime soon and for the good times to be a few months away will be disappointed. The wider economy - and the retail industry specifically - is facing huge headwinds. The new secular forces are new and nasty - at least for the weakest players and those who are least prepared. However, for the best players - be they investors, developers, landlords or retailers - the years ahead represent a massive opportunity to refocus, realign and prepare for the upturn when it comes in the second half of the decade. Will it be a question of five years of repositioning for five years of gain?

From here on, we focus in more detail on these powerful forces impacting the fundamental structure of the retail industry. Whilst, so far, we deliberately avoided pinning down the property implications in Retail 2020, the time has come to leverage the results into prototype action plans and give direction on how to deliver future-proofed strategies. The rest of this report focuses on these strategic actions. Starting with Lesson #1, concerning the most powerful force of all; technology.

For the best players
– be they investors,
developers, landlords
or retailers, the years
ahead represent a
massive opportunity
to refocus, realign and
prepare for the upturn
when it comes in the
second half of the
decade. Will it be a
question of five years
of repositioning for
five years of gain?



Lesson #1: Approach technology as a mindset, not merely a tool

Shopping as we know it is dead. Long live consumption

As we forecast across much of Retail 2020, technology will be *the* gamechanger for the industry across the decade. There is no bigger disruptive force in retail today. It affects everything from channel strategy, the nature and place of transactions, pricing and price negotiation, shop-as-showroom, lease agreements, shopping centre communications, stock and transport logistics, payment systems and so on. In fact, technology's influence is now so pervasive, that we should probably talk about 'techtail' rather than retail.

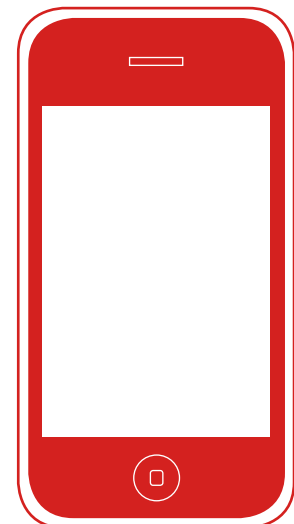
Faced with this challenge, a few years ago, the big question being raised by retailers and shopping centre managers alike was: how do we fight the internet revolution? The thinking was that the internet was just another channel, another competitor.

To some extent, this thinking still prevails across the real estate industry. So we get defensive statements like:

- "People want to touch and feel".
- "People like shopping and there will always be a role for bricks and mortar shops".
- "Shopping centres will always be appealing due to their ability to protect shoppers from extreme weather".
- "Customers like an outdoor lifestyle".
- "Shopping centres are the new heart of the community".

None of these observations is wrong, but when they are used to justify shopping-as-was, they can lead to status-quo thinking.

So here's the point. When it comes to 'bricks and mortar' shopping or internet based 'e-commerce', customers increasingly don't care. They do what is convenient for them at that time, that place, that mood, that budget. They figure out quickly how best to do it *on this occasion*. Will they source online and then buy in-store? Yes. Will they source in-store and then buy online? Absolutely. What about information seeking online or in-store? Well it's neither or both or sometimes one or the other. We estimate that, by 2020, in certain, more mature markets, more than half of all non-food retail transactions will be digitally influenced.



In the sense that 'shopping' is about buying by going out to the shops, then shopping as we know it is dead. 'Consumption' is not about where you *go*, it's about what you *do*. What are the implications of this radical change in consumers' attitudes and behaviours?:

All commerce:

The managerial mindset of seeing the internet as an external competitor is all wrong. Over time, as more personnel in the retail industry understand this, we will see the vocabulary change: 'e-commerce' will start to be irrelevant: it's '*all commerce*'.

Once again, where consumers see the offer as seamless, the only response is joined up thinking. Changing managerial mental maps will give rise to a more joined up strategic response. Cross channel product information. One logistical circuit. Holistic branding. And, going forwards, it will be inconceivable not to have a fully functioning online presence in the marketplace. It *is* what retailers *do*. It *is* what shopping centres *do*. The Westfield online shopping mall (www.westfield.com.au), which allows consumers to transact with both its physical stores and pure online stores, is not a gimmick, or even a sign of being ahead of the game: it's about being aligned with *today's consumer needs*. Click and Collect, which seamlessly combines clicks and bricks, is in its infancy, but is set to explode over the next decade.

Communication:

Senior staff have to realign their culture to this new mindset. Every time they hear staff say "some customers are put off when we become too slavish to technology" or "people will spend less online because they love our in-store / in-centre experience", this needs to be stamped on. The consumer wants both, not one, nor the other.

The consumer (and for that matter, increasingly staff) also wants a dialogue – but one which uses the right channels. Think Facebook, MSM, twitter and SMS text rather than email or newsprint; and it won't stop there! Interactive poster sites and streaming video to mobiles will be commonplace over the mid-term.

When it comes to 'bricks and mortar' shopping or internet based 'e-commerce', customers increasingly don't care. They do what is convenient for them at that time, that place, that mood, that budget.

Fad or value add?:

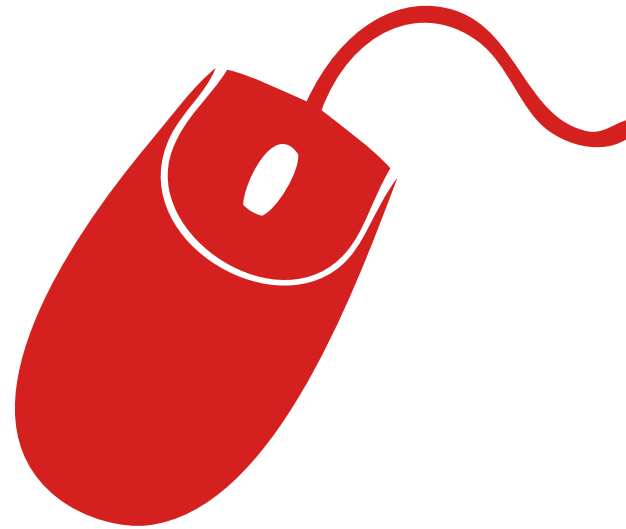
Not all tech is the internet, and not all tech is inherently good for business. You need a way to filter fads and fashions. Some principles are: decentralise trials; fail fast; don't put all your stakes on one technology; do a few things really well; evaluate coverage; measure conversion and usage; use age-old rules to judge merits ie. the orthodox rules of branding or classical communication guidelines. In essence, don't do it just for the sake of it.

Avoid the many tech pitfalls; here are a few traps to avoid in technological adaption: don't slavishly follow what's hot in the press or the latest 'cool'; avoid anything that appears time-wasting at first glance – it probably is; don't bend to peer pressure or competitive pressure – make your own decisions; don't waste a good initiative due to poor management of the roll-out; and finally don't think: "this is so far down the road for us, we'll come to this later". Make no mistake, it has arrived.

Mindset more than skillset:

Asking the technophiles in the business to use their technology skills to bring the business up-to-date regarding latest technologies is one thing. But changing management mindsets is another. Managers need to be able to *feel* the power and excitement of all sorts of devices and apps by getting their hands dirty. It is only by understanding *as a consumer* how compelling some of this stuff is, that the right roll-out decisions will be taken. Being a senior retailer, a shopping centre manager or even a landlord, now means mastery of the technology 'portfolio'. Nothing less will do.

In sum, the internet is a sewn in part of the consumer mindset and needs to become similarly integrated in retailers' make up: the vocabulary, the internal communications, the offer, the delivery. Tech is a mindset, not just a toolbox.



In the sense that
'shopping' is about
buying by going out to
the shops, then shopping
as we know it is dead.
'Consumption' is not
about where you go, it's
about what you do.

Lesson #2: Sustainability is a big risk, and opportunity, for retail investors

*Up to 15% of Shopping Centres could be unsellable
from 2018 in certain markets*

In principle, investors in quality new build shopping centres should be able to look forward to a substantial green premium. The centre should be more efficient and cost effective to run and rental levels less likely to be discounted for a well-designed and managed centre that is demonstrably more efficient. Overall, the centre should be more attractive than its non-green neighbour and easier to sell down the line. Risks fall as a consequence.

Certainly, this is what is happening in the office sector, where early quantification points to higher tenant satisfaction, lower costs, higher productivity, lower vacancies and the protection of rental levels. Indeed, sustainability is a mantra which has overtaken even the most sceptical of office investors – the business case proves that green is simply good commercial practice.

Given where we are starting from, the danger is for sustainability to catch the retail industry on the back foot over the coming decade. Some of the detailed risks are:

**The business case
proves that green
is simply good
commercial practice.**

For developers;

- Being behind the legislative curve and building shopping centres for yesterday's standards. (Incidentally, a future-proofing motivation is driving a lot of office investors to go *well beyond* current government eco-specifications in their recent projects).
- Not factoring in water shortages for schemes in hotter climates.
- Paradoxically, being too green for the marketplace.

For investors;

- Smaller investors and institutional investors losing ground versus the big sector specialists who will be able to take learning from one green shopping centre to another.
- In any acquisition, not asking about both the green credentials of the building, and the carbon-based operating performance of the centre managers.
- Missing the point at which onsite technologies like renewable energy and grey water recycling become financially attractive (as well as visible indications of an investor's commitment to sustainability).
- Investors exposing themselves by underestimating the different policies by country.

For landlords;

- Smaller landlords risk being caught out when a lack of certified management systems or high quality buildings certification finally matters in terms of trading and/or valuation.
- Not protecting long term rental levels.
- Not having a policy on how to share the carbon costs between landlord and tenant.
- Lack of clarity in some jurisdictions about whether the whole shopping centre or individual units within require certification.
- Escalating costs associated with not being sufficiently green.
- Having ethical retailers or investors calling landlords, and ultimately the government, to account.

For retailers;

- Getting things right at the corporate level and then allowing local management to ignore centralised green imperatives e.g. on energy saving.
- Having ethical consumers or investors calling retailers to account.

This list is already long and only just scratches the surface of the issues surrounding sustainability. Three things are readily apparent. Firstly, insufficient dedication to these issues is going to leave companies exposed to higher risks. Secondly, all players across the industry - and of whatever size - have some exposure to the risks which could lead to worrying horse-trading down the line when legislation really starts to bite. Thirdly, whilst some players are trying to get ahead of the green agenda, many are late (too late??) to the party.

So, instead of saying things like “cost cutting in energy is not a priority as it is a very small part of my operating budget”, the retail industry should be focused on getting their arms around this issue as fully as possible. This will require many actions, some of which are:

Intelligence:

Staff up or buy in consulting knowledge - this is both a strategic and a technical area with huge implications for valuations, yields and operating costs. It needs specialist focus.

Get ahead of the legislation:

Forecast what's coming at a national and European level and build beyond that.

Metrics:

Certification is a muddle and measurements need synchronising (though there are signs of hope for greater consistency, e.g. EPRA BPRs, GRI CRESS). But companies just have to get on with it as best they can. Cradle to grave carbon counting and shopping centre utility sensors will become a fact of life. Get used to it.



Best of breed:

There will be an increasing emphasis on learning from experience. Rather than simply benchmarking sensitive environmental issues across the portfolio, the approach needs to be, how to roll-out best practice.

Regeneration and refurbishment:

Harsh legislation (standards and timing) could sink many. Best to be on hyper alert and evaluate here and now, the cost of materially bringing the property portfolio up to a given standard.

Prioritise capital expenditure:

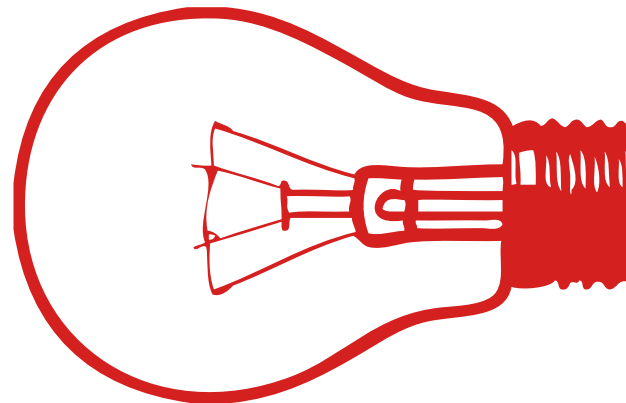
Whilst it is important to mitigate against risk, retailers cannot green everything immediately. Companies need to evolve a strategy here. Perhaps it's about greening the Head Office and flagship stores first, then the rest of the portfolio. Or maybe, going green follows the 'normal' refit cycle. Finally, some retail occupiers will now not accept new leases without certain green standards being met.

Promote the benefits:

A green shopping centre, for example, should be more efficient and cost effective to run, with lower energy costs ultimately feeding through to lower service charges for retailers. Crucial at a time when retailers' margins are under intense pressure.

It is clear that the ethical debate has run well ahead of commercial real estate's ability to measure, let alone react. However, this issue is not going away: commodity prices will rise on falling and vulnerable supply; transport costs will be hit; ethical society will not back down; reputational risks will only increase; and environmental catastrophes and imperatives will continue to keep the issues on the front of newspapers and minds. The green evolution will be driven initially by the consumer, then retailer and landlord, with the government being the ultimate enforcer of the sustainability agenda.

Green retail leases show that some within the industry are starting to get it. However, the scary news is that some legislation could severely hit property valuations. For example, the Energy Bill in the UK proposes that from 2018 assets, including shopping centres, that have EPC ratings lower than an 'E' would be prevented from being let or sold. We anticipate this could affect up to 15% of UK shopping centres. Now that sobering thought should turn everyone in the industry green – but not with envy.



Lesson #3: Partner, upskill and diversify to survive

Just doing the day job is the road to ruin

In 2010, a leading European REIT recruits its Sales and Marketing Director from the FMCG industry and in 2011 a Non-Executive with 25 years' experience in technology. A wise head in the Italian retail property market talks of landlords misjudging the size of the earthquake. A Dutch expert quotes a tendering process where fresh graduate architects pitted their wits against the CEO's team – and won.

What is going on here? What is the connection between these sound bites?

Clearly, retail real estate is in mutation, hit by the secular trends we have mentioned, as well as deepening cyclical recession. And the key to survival and growth is, at the end of the day, not assets, not funds, not systems, not processes – but people and their attitudes. Nothing has a value without the employees to realise it.

So experience, talent, diversity, culture – these things become tested and accentuated in tough times. As the saying goes, anyone can be a marketing director when times are good. Only the best survive when times are bad. Perhaps anyone can work in the property industry when times are good? And what actually happens when times are difficult?

Human resource issues have already come up throughout this chapter – and so they should. Here we dedicate our insights to corporate solutions and look at the measures companies should be taking:

Neck on the block:

In our cosy corporate world today, it's a brave man who sticks his head up and says something radical, innovative, or counter-intuitive. And yet, to create a premium to the market, something has to be done differently to, better or more cost-effectively than the competition. Intrapreneurialism, a culture which encourages risk, where entrepreneurs are rewarded and encouraged within a corporate environment, is key to stimulating growth.

Flexible structures:

It is true that where the structures in an industry are slow moving and long term, management will be slow moving and long term. Creating a vacuum, working rather than managing assets, flipping – all nourishment to your talented operators. Turnover rents progressively will be seen as a fact of life and a smart way of aligning owner, manager and tenant interests. Nevertheless, this is a hard pill for investors to swallow with its implications for risk premiums and therefore valuation discounts.

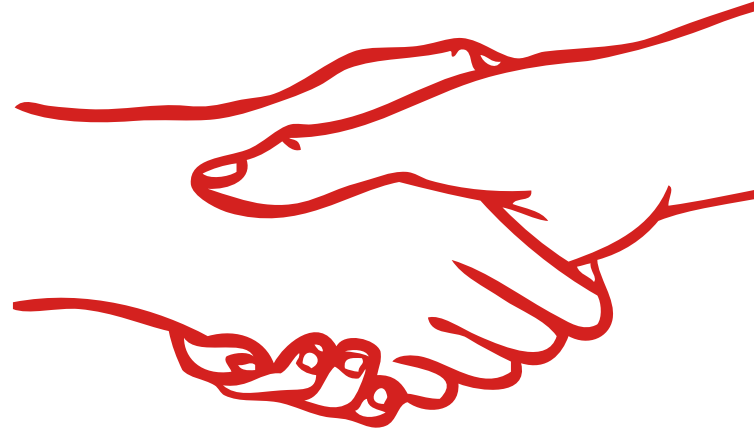
Partnerships:

Upskilling is also about bringing in experts, collaborators, associations etc. from the outside to add new blood and keep the melting pot boiling. Outsiders also tend to ride a bit roughshod over very neatly defined fiefdoms and silos. Never a bad thing. Retailers and institutions will increasingly turn to specialist owner managers whose influence will thereby balloon over the decade. They will offer experience, top class assets and real partnership for those seeking long term asset returns.

We will see more partnerships between those with equity, such as sovereign wealth funds, and those with expertise, driven partly by the increasing amount of wealth creation in the East targeting European Real Estate. Those with capital but limited expertise will seek market knowledge and experience from those established property companies with a track record, and with strong retailer relationships.

Non-sector recruitment:

Most professions are at it. Law partnerships now want to employ non-lawyers; accountants want people without accountancy training. Diversity is key. If the sector upskills too slowly, it will miss the market. Is it too radical to suggest that there are too many surveyors working in real estate, and that fresh blood from retail, technology, service and other industries is urgently required?



Together, this suggests a more agile, open and rich pool of employees for retail real estate. The same requirement could be asked of retailers, of course. And the conclusion would have to be that having the same employees doing the same tasks for the next 5 years is not going to get you where you need to be. Faced with the future, doing the day job is no longer enough. In fact its the (long) road to ruin. Employees need to be asked to stretch and move beyond a herd mentality.

The key to survival and growth is, at the end of the day, not assets, not funds, not systems, not processes – but people and their attitudes. Nothing has a value without the employees to realise it.

Lesson #4: Get them and keep them

Marketing comes of age

Getting them and keeping them - this most basic of retail principles - has come back into its own. And achieving customer magnetism in these straightened times means marketing has to come of age.

Of course, marketing is much maligned. Delivered by those guys who abandoned their ties in the office before everyone else, it is often thought of as 'common sense, made complicated'. Indeed, there are lots of pitfalls with poor marketing:

- becoming too intellectual about branding – thinking rather than doing
- being over-reliant on focus group research – classroom rather than real world
- obsessing about the 'brand wrapper' rather than the quality of the product itself
- looking at people exclusively as consumers rather than individuals with real lives
- communicating in tactical quick bursts rather than long term brand building; seeing branding as a one-off hit
- not being able to measure accurately Return on Investment
- being corporate rather than entrepreneurial – throwing money at issues rather than clever, cost effective ideas.

All told, looking at shopping centres, it is clear that, with exceptions, marketing is underplayed and often poor. Few know how to market shopping centres as winning differentiated destinations. And much of the marketing budget under-delivers. What is needed, above all, is marketing that brings people in and keeps them there. This means letting consumers know you are there and are different. And it means having an offer that keeps them interested – and ultimately spending. Easy to say, but what, as a retailer or landlord, should you be actioning?:

Audit:

Don't just do things the way they've always been done. Audit the budget and refuse to reinvest in spending on activities that have little impact or return. Marketing activities need to demonstrate that they have met set objectives. Practically, one element of the audit is to work with actual retail sales data to better understand the campaign performance.

Customer base:

Old hat, but knowing your catchment, your target segments, and how to appeal to their needs and wants should be at the root of every decision; the aim is to 'own' your customers' loyalty - hearts and minds (and data). Everyone claims to know their customer base, but how many actually do?

Technology:

In a way, central to everything, and the key to driving footfall, sales and awareness. Whilst some technologies that have previously failed were simply ahead of their time, much of what is being communicated today can be supported and/or replaced by technology for little cost. Technology will make leaflets redundant and updates can happen at the push of a button; centralised and local messages are easier to handle than paperware. Promotions and institutional messages are easy to push to mobilephones and computers. Games are fun and interactive.

Social retailing:

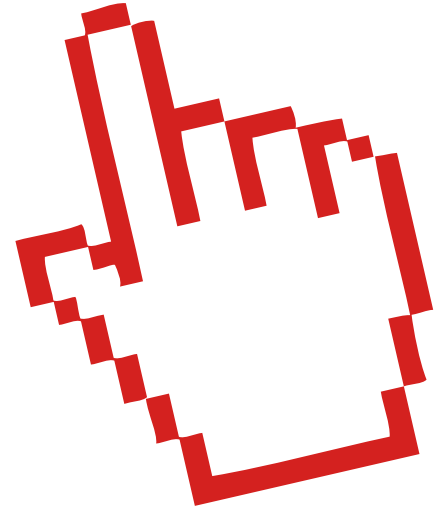
The next big thing, and a vital weapon in the shopping centre marketer's armoury. The aim is to get the shopping centre at the heart of the online community as well as the physical community. Does your centre have an app, do you Facebook and Twitter? If not, then you may be losing ground. This is where hearts and minds can be won or lost.

Product:

Shopping centres have to be viewed as a product, and product marketing principles applied. It's about being a 'place maker'. The key here is to think of a shopping centre not just as a place to shop but as a social space that you can also shop in! Delivering this requires marketing to move upstream and take a firm lead at the very outset of new developments. Most developers and landlords are still building and managing too many boring boxes.

Joined up thinking:

There has to be a win-win mentality where landlords and tenants try to outsmart competing centres, not each other. There should be absolutely no division between getting people to the centre and getting them into stores. What it's about is getting people to consume.



Few know how to market shopping centres as winning differentiated destinations. And much of the marketing budget under-delivers. What is needed, above all, is marketing that brings people in and keeps them there.

Brand positioning:

All successful branding depends on creatively appealing to the target audience's hard-wired need for personal identity. To get there, it's important to stand for one or two things and do them really well. Being the biggest and best fashion destination, for example, means a dominant tenant mix, but also catwalk shows, designer guest appearances, links on your website to online fashion portals, promotional trips to fashion shows in Paris or Milan etc. And, of course, the positioning needs future-proofing; it's got to be relevant at launch – and well beyond.

Outside the box:

The best marketers think wide. Bicester Village factory outlet centre packages and promotes itself outside of Europe and has a dedicated team involved in tourism and digital marketing of the *Chic Outlet Shopping* brand. The result? Plane-loads of tourists coming to middle England!

Be awake to current trends:

Taking one example; consumers, tired of just buying 'stuff', are increasingly aware of the provenance of their goods, and are hungry for transparency and information. Witness the Madrid-based IOU Project, which attempts to connect the buyer with the source of their garment, via an internet link tracking the journey from wearer to weaver. Marketers need to anticipate and react to the drivers of consumer behaviour.

Upskill:

Shopping centre management teams need to be complemented with young, tech-savvy, specialist consumer marketing talent.

This means letting consumers know you are there and are different. And it means having an offer that keeps them interested – and ultimately spending.

Real financial results come from the right marketing calls. As retail guru, Paco Underhill, says: "most shopping mall operators have realised that they can't just sit back and just be landlords". The time has come for marketing to step up to the plate. It must never be a cost – but always an investment generating returns.



Lesson #5: Quality (or true convenience) will out

A sizeable amount of secondary space is not vacant – it's obsolete!

The nature of globalisation, of instant electronic communications, of ultra mobility, has been to move much of society from middle-of-the-road, average and mediocre to a world of non-linear, exceptional extremes. Translated, this means that we are seeing the rising phenomenon of 'concentrated success': the rise of superstar celebrities, mega rich sports people, fantastically attractive Winning Cities.

Put another way, the world increasingly obeys the law of attraction: to those that have, more shall be given.

And the relevance? The retail marketplace is subject to these same dynamics and, indeed, is itself a great illustration of the phenomenon. It's now all about big schemes in big centres. It's all about extremes – best leisure, super dominant offer, regional catchments, highest design elements. Ultimately it's about quality, or true convenience.

At the other end, the mediocre end, what is being washed out, is an old model, a way society used to organise itself before it became fluid. Poor local high streets, non-dominant secondary shopping centres, inconvenient bulky-goods focused retail parks.

We see this extreme model everywhere. In America, of course. In a number of emerging markets, the high street never existed, but the local co-ops and street markets are wasting away in the presence of gleaming new shopping centres. Across Europe, major players are actively focusing on the biggest and best in their portfolios.

Understanding that this is a long-term structural change in the way society organises itself and rewards itself, puts a different slant on the current shake out in retail's location hierarchy. It suggests, for example, that non-dominant, non-focused secondary space will never again reach the valuations of 2007. It is mediocre space that is simply out of time. Old style shopping centres? Out of time. All told, this points to the fact that many vacancies will never be filled and what we are looking at is large scale numbers of units being classified not as voids but as obsolete. We estimate that up to 30% of retail space in developed markets is potentially obsolete in its current form – a frightening statistic.

Here's another characteristic of our exceptional society: extremes tend to be scalable. This means that there is the tendency for the winner to take all. This suddenly becomes scary. We are starting to witness what might be called 'black hole retailing'. Prime, dominant centres which suck in so much of the spending in their regional catchments, that they leave increasingly little for former prime, secondary and tertiary locations. Hypermarkets have, for many years, had the same 'black hole' effect on their local catchment's food (and now increasingly, non-food) spend.

We estimate that up to 30% of retail space in developed markets is potentially obsolete in its current form – a frightening statistic.



The more you look, the more you see the effects of the exceptional model. Zara, for one, is exceptional, and now can go into almost any scheme, it seems, on favourable terms. Tesco is exceptional and commands 1 in every 8 pounds spent in UK retail. The likes of Abercrombie & Fitch, NikeTown and Apple have a roadmap for Europe which takes in iconic buildings in world class cities; nothing less.

Let's look at the consequences for investors and landlords.

Expansion:

Europe is not over-spaced in the sense that it cannot take any more. In fact, it can take millions of square metres of state-of-the-art prime space. On the other hand, Europe has lots of poor quality mediocre space in the wrong places. The decade ahead will provide opportunities for the well-funded seekers and providers of quality.

Qualifying diversity:

A Boston Consulting Group portfolio approach to investment (using the classification: cash cows, stars, dogs and question marks) is not looking so wise. Whilst the secondary retail market does offer opportunities for those able to sort the "wheat from the chaff", the true 'dogs' will just get worse. Some stock on the investment cycle may never move round the clock face again. It's clear that the best investor manager companies are taking the strategic view that quality counts.

Institutional free zones:

Following the logic of the above, some weaker secondary centres will see an increasing lack of institutional fund appetite. Refinancing will be crucial for these assets; equity is needed to combat the lack of available finance, and yields need to move out to make these assets affordable. Someone will have to take the pain!

Bite the bullet:

Investors holding mediocre assets will have to try to stabilise their portfolio by getting in tenants, at whatever rent. By taking the hit, the hope is to stop the spiral and wait for the wheel to turn. The key is to do something, and stop the drift.

Converting use:

Given the fact that Europe arguably has too many poorly located, sub-standard offices and given the lower rental levels in all commercial uses versus retail, conversion to office use is not a very palatable option. Residential remains a contender, however. Change of use will be a further trend confirming the power of the black hole effect.

So is all lost for the stranded assets on poorly located and assorted retail parks, secondary high streets and non-dominant shopping centres? No! Here are some strategies for a fight back:

Local alliance:

Coordinated management involving the whole community including, of course, local government bodies, is key. The Birmingham Alliance (www.birminghambusinessalliance.com) is one stand out example of where this worked. The idea is to assemble large chunks and redevelop them.

Doughnut model:

It may well be that the traditional High Street has to shrink back and be focused around a new core. The core would consist of local retail, designer or artisanal, fresh produce and local services - rather than just charity shops and betting shops. The kind of High Street that France has successfully managed to keep (albeit aided by a retail market skewed to the needs of the occupiers). In a sense this is like a neighbourhood centre relocating itself to the heart of a former High Street. Around the doughnut, much of the secondary space is not merely vacant - it's obsolete.

Remove the barriers:

Non-competitive car-parking charges, wieldy lease structures, over-complicated planning processes, uninspiring public realm spaces. All unnecessary, all relatively surmountable, ultimately all barriers to competitiveness.

Re-pricing:

Lowering rents or shifting vendor expectations on yield. It's about being proactive to stop the rot!

Let it go:

Some High Streets will simply die over time, and there will be no escaping this reality. The idea is to be ahead of the game, changing and adapting, or be well gone before the music stops.

This double squeeze means that weaker secondary space is dying and becoming obsolete. Time to realign that portfolio – and quickly.

To summarise, whilst customers have always wanted the best of the best, today's fluid society concentrates this motivation and leads to a winner-takes-all result. Quality retail locations have created a black hole effect, dragging in spending, whilst the recession hits the spending of the very people who might otherwise have stayed on the High Street. This double squeeze means that weaker secondary space is dying and becoming obsolete. Time to realign that portfolio – and quickly.

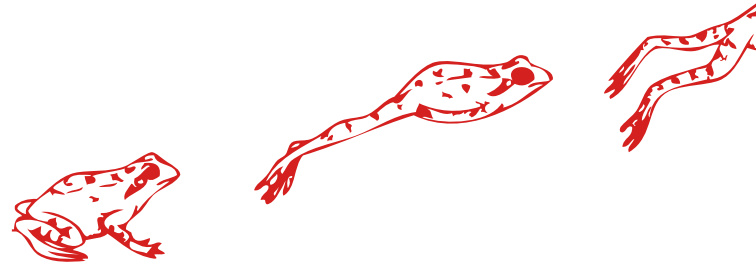


Conclusion

A pattern of paradoxes has emerged in the new Retail landscape. The 'bad' recession brings opportunity for some; the internet should be folded into what it means to be a retailer or a landlord; sustainability represents both a looming risk and potential opportunity; new blood with no retail experience could provide the key to success; the old principles, such as 'get them and keep them', still apply in the new world; and quality counts above all, even in constrained times. Welcome to the new normal where the impacts of trends are non-linear, interwoven and multi-dimensional.

The retail industry has been knocked out of its comfort zone. The return of the good times towards the second half of the decade will be welcomed by everyone. Meantime, there will be lots of changes, some pragmatic, others marking a new paradigm. Many of the changes we see in the functioning of the industry, highlighted above, are likely to survive despite any upturn.

In both retail and retail property, we will see the good survive and slowly get stronger and the bad will falter and need to re-think their raison-d'être. As for the ugly, the outlook is bleak; with neither the consumer nor the retailer in a position to absorb the pain, for weaker secondary locations, the buck stops with the landlord, or in some cases the bank. There is no need for despondency, however. What is needed is clear strategic analysis and an action plan:



1. Approach technology as a mindset, not merely a tool
2. Sustainability is a big risk, but also opportunity, for retail investors
3. Upskill, partner and diversify to survive
4. Get them and keep them
5. Quality (or true convenience) will out

We hope this latest Chapter provides the inspiration and the courage to move forward with a certain confidence.

**It bears repetition;
change is here, the water
is bubbling - are you
ready to jump?**

If you have any questions about this report, please contact us at:

James Brown
Head of EMEA Retail Research
+44 (0)20 3147 1155
retail2020@eu.jll.com
www.retail2020.com