THE CHANGING FACE OF RETAILING:
IMPLICATIONS FOR REAL ESTATE INVESTMENT

by

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Submitted to the Department of Urban Studies and Planning on August 25, 1993 in partial fulfillment of the requirements for the Degree of Master of Science in Real Estate Development

ABSTRACT

The retail industry has experienced significant structural change in recent years. Traditional retail formats have faced fierce competition from relatively new forms of retailers including category killers, specialty stores and warehouse clubs. The changing retail landscape raises new implications for retail real estate investment. These implications are explored in this thesis.

The thesis first documents the factors that have driven the industry change, including economic conditions, demographic trends and consumer attitudes and shopping habits. Next, the primary types of retailers are described, and their recent sales performance is examined. Predictions for the industry, based largely on the sales performance analysis, are then presented. The thesis concludes by discussing issues that should be considered when investing in the new retail environment.

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INTRODUCTION

Heraclitus' observation that "nothing is permanent except change" can well be applied to the retail industry in the United States. In recent years, many changes have affected this nearly two trillion dollar industry.¹ With a stagnant economy, a tight labor market, high debt levels and demand for many goods nearly satisfied, consumer spending has been restrained. The slowdown in consumer spending has left retailers in a fierce struggle for market share in an industry complicated by labor shortages, shifting demographics and changing public tastes. These factors have already resulted in a shift of market share from department stores to narrowly focused discounters and specialty retailers. In this volatile environment, retailers aggressively seeking to attract customers are offering increased merchandise depth, better customer service and the lowest possible prices, made possible by the use of the latest technology to minimize inventory and operating costs.²

This thesis documents the recent trends in the retail industry, particularly focusing on the performance of the

¹1992 Total U.S. retail trade, U.S. Department of Commerce.

various common retail formats. This documentation will allow for the discussion of the implications of the retail trends and recent and projected sales performance for real estate investment.

Chapter I presents an overview of the general state of the retail industry. Included in this chapter is discussion of factors that shape the retail industry including economic conditions, demographic trends and consumer attitudes and shopping habits. Chapter II provides descriptions of the primary types of retailers present in the industry. The recent performance of these retailers is examined in Chapter III. Chapter IV first presents predictions for the industry based on consideration of the factors contained in Chapter I and the retail performance trends discussed in Chapter III. Chapter IV concludes by discussing retail property investment considerations given the state of the industry.
1. STATE OF THE RETAIL INDUSTRY

Prior to analyzing the performance of specific types of retail formats or individual stores, it is necessary to examine the overall state of the retail industry. In this manner, the arena in which specific retailers compete can be understood. The chapter begins, therefore, with an overview of the industry's total sales levels. Next, the chapter discusses the nation's economic and demographic conditions, for it is these factors that shape the retail environment. Consumer spending patterns are, for example, greatly dependent on the state of the economy. In robust economic times, when income is rising and job security is felt, consumers will spend more freely. Conversely, in a poor economy, when employment falls and those with jobs worry about losing them, spending is curtailed. Retail analysis must, consequently, carefully track key economic indicators such as inflation, interest and unemployment rates, and levels of disposable income.

The examination of demographics is an integral aspect of retail industry analysis because demographic trends often underlie shifts in the types and quantities of industry merchandise sales. Changes in the composition of the population are, therefore, closely observed by retailers. One key demographic consideration is any change in the number of people within each age group in the total population, as the
spending habits of the age groups vary significantly. Older adults, for example, tend to spend less than their younger counterparts for apparel or entertainment items, but more on services and health care.

Next, the chapter discusses consumer attitudes and consumer optimism. Consumers attitudes indicate the characteristics that are desired and expected in retail establishments while consumer sentiment, notwithstanding the state of the economy, largely influences spending; when consumers are optimistic they not only buy more, but are more willing to incur debt in order to make purchases. This was the case in the 1980s when rates of borrowing were high. In the first years of the 1990s, however, consumer pessimism curtailed both spending and borrowing. Leading surveys of consumer sentiment are performed by the Conference Board and the University of Michigan. These surveys enable retail analysts to predict spending patterns.

The chapter concludes with a brief look at innovations in retail technology. In the today's competitive retail environment, merchants must implement the latest technological systems in order to increase productivity; retailers who do not have the capital to invest in these systems face an increasingly difficult struggle to remain in business.
Retail Sales

This section presents a general overview of the retail industry's sales levels. A more detailed description of the sales figures is presented in Chapter III.

The retail sales industry is a significant sector of the nation's economy. Retail trade is defined as businesses selling goods for household use and personal consumption. Figure 1.1 graphically portrays real and adjusted retail trade levels within the United States for the past ten years.

FIGURE 1.1
Total Retail Trade Levels

Source: U.S. Department of Commerce
As shown in Figure 1.1, total unadjusted retail trade has grown substantially (approximately 5.9% annually) over the ten year period to a level of just under 2 trillion dollars in 1992, approximately 30% of the nation's Gross Domestic Product.\(^3\)

National retail statistics, compiled by the Department of Commerce, divide retail trade merchandise into two groups: durable and nondurable goods. The durable goods group consists primarily of items such as furniture, appliances, building materials and automobiles. Nondurable goods are those that are typically sold in apparel, variety and food and drug stores. As shown in Figure 1.2, the total national revenue from the sale of nondurable goods over the last ten years has been nearly twice the level generated by durable goods.

Figure 1.3 presents a distribution of the nation's sales according to type of business. As illustrated in this figure, automobile dealers and food stores together account for 40% of total sales. Stores selling general merchandise, miscellaneous goods and apparel had combined sales that represented over 20% of the nation's total. This relative distribution of sales has remained fairly constant in recent

FIGURE 1.2
Total Durable and Nondurable Good Sales

Source: U.S. Department of Commerce

FIGURE 1.3
Distribution of the Nation's 1992 Total Sales
By Business Type

Note: "Other" includes hardware/bldg. materials, gasoline, drugs and liquor.

Source: U.S. Bureau of Economic Analysis
years. In 1983, for example, food stores had sales that represented 22% of the total, while stores selling general merchandise, miscellaneous goods and apparel, and automobile dealers both accounted for approximately 20% of nationwide sales.4

As previously noted, the retail industry in the United States experienced significant growth in overall sales in the 1980s; household expenditure on GAFO, or general merchandise, apparel and accessories, furniture and home furnishings, and other items such as sporting goods and books, rose throughout the decade at an annual compound rate of 7.2%. The GAFO sales growth slowed dramatically, however, during the first years of the 1990s, and is projected to experience annual compound gains of only 3.5% to 4.0% through the remainder of the decade.5

Economic Conditions

There are several reasons for the growth in sales in the 1980s and the slowdown in the early 1990s. Household spending varies according to a number of factors such as consumer age, confidence and disposable income. During the 1980's, low

---

4Percentages are based on data compiled by the U.S. Bureau of Economic Analysis.

taxes on the wealthy coupled with increasing incomes and home values led to high levels of borrowing. The lethargic economy of late, with its tight labor market, has, however, severely eroded consumer financial security and optimism. Also, the fall in home values has led to a structural reduction in consumer debt-carrying capacity. Consequently, today's shopper has less inclination and ability to borrow, is increasingly value-conscious, and has generally delayed the purchase of non-necessity and big-ticket items.

The trend described above is reflected in Figure 1.4. This figure shows per capita disposable income and personal consumption expenditure.
consumption expenditure, in current and constant dollars, for 1980 through 1991. As illustrated, real personal consumption expenditure has leveled off after steady gains through the 1980s.

**Demographic Trends**

The nation's changing demographics is another primary reason for the slowdown in sales growth. In the 1970s and 1980s, the "baby boom" generation - those born in the years following the second world war and constituting about one quarter of the nation's population - were establishing households, and spending liberally in the process. Now, however, the baby boomers, presently 29 to 47 years old, are increasingly settled. Household formation has thereby slowed from a peak of 1.6 million new formations per year in the 1970s and an annual average of 1.3 million through the 1980s to just under 1.0 million annually in 1991 and 1992. The heavy revenue, generated by the sale of items such as furniture and appliances that accompany household formation has diminished accordingly. Furthermore, though the boomers are approaching their peak earning years, they are saving for retirement and spending a greater percentage of this income on raising and paying tuition for their children, rather than increasing their consumer good purchases.
The overall aging of the nation's population will also have a negative impact upon the retail industry. As shown in Figure 1.5, the percentage of young adults in the population will decline over the next two decades. Though the percentage of adults who are 35 to 54 years old is projected to grow substantially\(^6\), and adults of this age typically outspend

\(^6\)According to U.S. Bureau of the Census projections.
younger adults on goods such as home furnishings and apparel, the growth in the number of people who are over 54 will hurt the industry. This group is growing at an annual rate of 2%, compared with an overall rate of 1% for the population as a whole. While the over 54 age group controls about half of the nation's discretionary income (and three-quarters of its financial assets), they spend significantly more than other age groups for services, health care and leisure activities and considerably less for goods such as apparel and home furnishings. Those who are over 54 spend, for example, less than $800 annually per household on apparel expenditure, versus the overall household average of over $1100.7

The classifications shown below provide brief characterizations of the general spending habits of the population according to birth year. These classifications and descriptions are as written by Wilton Anderson.8

- **Depression Babies** (1930-1939) began life with rationing but grew up in relative comfort in the post-World War II period. At or near retirement, their consumption is defined by comfort and conservatism.

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7"A Decade of Change," Chain Store Age Executive November 1988, pp.55-77.

World War II Babies (1940-1945) grew up during the boom years following World War II. At the peak of their professional and occupational stature and income today, they are less conservative than their predecessors yet intense bargain hunters.

Mature Boomers (1946-1950) experienced adolescence amid the social and political upheaval of the 1960s but have retreated from the front lines of activism into conservatism while grudgingly losing their grip on youth.

Mature Busters (1965-1970) are the MTV generation, long on external stimulation and excitement-orientation but short on interpersonal communication skills.

Mature Boomlets (1977-1982) are highly indulged, relatively affluent adolescents with great influence on family consumption.
In the 1970s and 1980s, the large number of women entering the work force helped spur growth within the apparel industry as these women required working wardrobes. Interestingly, the advent of women in the workplace has had a dramatic affect on other more improbable segments of the retail industry. The founder and CEO of Toys "R" Us, Charles Lazarus, for example, credits the creation of a new group of customers who buy toys year-round to working women. These women buy toys out of the guilt they feel for being away from their children. According to the Bureau of Labor Statistics, the number of women in the labor force has, however, essentially held steady in the last three years, and the projected rate of growth through the remainder of the decade is significantly lower than that experienced in the '80s. Increases in apparel sales due to women entering the labor force will, consequently, not be as dramatic, in relative terms, as those previously realized.

Demographic changes in the past decade have also been responsible for shifting the focus and strategies of many of the nation's retailers. In the 1980s, the percentage of middle income households decreased while the percentage of upper income households grew significantly. As a result, stores that targeted either the upper or lower ends of the consumer spectrum fared well, and many retailers entered the upscale retail market. Stores that had performed well in earlier years by catering to the middle class struggled.
Traditional department stores such as Montgomery Ward, J.C. Penney and Sears Roebuck & Co. were particularly hard hit, losing customers en masse.

In addition to decline of the economic middle class, the demise of traditional "middle class" values brought about by the increasing fragmentation of American society has created new opportunity for specialty retailers. These retailers have taken advantage of the broad range of lifestyles in the United States today by narrowly focusing their merchandising toward specific customers. This trend has been aided by modern computer technology, which better enables retailers to gauge and target specific household buying habits. Specialty stores are, consequently, now present in virtually all merchandise categories. They are, for example, increasingly dominant in the hardware and building material industry, and even supermarkets have added specialty departments such as bake shops, flower shops and salad bars.

**Consumer Attitudes/Shopping Habits**

Changes in customer attitudes and shopping habits have also had a significant impact on the nation's retail industry. The dramatic increase in the number of dual income families and households headed by a single adult has made disposable time scarce, leaving most consumers limited time for shopping. As
a result, today's shopper demands convenience, both in store location and store attributes. Retailers are responding by improving the efficiency of the shopping environment: creating clearer displays; increasing merchandise assortment; streamlining customer checkout; and allowing for one-stop shopping. These measures are also designed to make the shopping experience more enjoyable. Recent consumer studies have indicated that shopping is no longer fun; customers no longer want to follow the credo of the '80s and "shop 'til they drop". The Lieber/Yankelovitch Monitor, for example, a measure developed by LAR Management Consultants and Yankelovitch Partners, Inc., found that the number of people who considered clothes shopping enjoyable dropped 4% from 1991 to 1992.9 Retailers must, therefore, make changes to remain competitive.

Changing customer attitudes have also altered the retail industry. More than ever, the shopper of the '90s seeks value: quality merchandise at reasonable prices. Many of the upscale specialty stores that formed in the 1980s have been hurt by this trend, as increasingly frugal customers frequent less exclusive stores that offer better value. Value alone, however, is not always enough. Some value retail formats (which will be discussed in the next section) have been

successful offering merchandise at very low prices and providing little service; however, customers are generally demanding higher levels of service from most retailers. They expect good selection and prices, liberal return policies, sales promotions and knowledgeable salespeople. Consequently, many retailers who have performed well in recent years have focused on customer service as a way of distinguishing themselves from their competition. Nordstrom is a prime example of one such retailer. Their success in the troubled department store industry can be largely attributed to a strong commitment to fulfilling the demands of discerning customers.

Some new attitudes exhibited by consumers have been induced by practices of the nation's retailers. In the last decade, for example, retailers have offered so many sales that consumers have become accustomed to waiting for markdowns before making purchases. Studies have, in fact, shown that sale prices must be at least 25% off to stimulate any customer interest whatsoever. For this reason, and because frequent sales can be confusing for customers and costly to retailers, some stores have shifted to an every day low price (EDLP) strategy. This strategy has been successful for stores like Wal-Mart and Toys "R" Us, who have generated high sales volume and gained significant market share through aggressive pricing, and is now being tried by Sears and Montgomery Ward in an effort to
attract customers. The EDLP approach offers the retailer many cost advantages over the conventional practice of frequent markdowns; EDLP enables the retailer to eliminate advertising expenditure for sales promotions and reduces labor costs because prices are not constantly changed. EDLP also results in a more even merchandise flow, allowing more efficient inventory control. Savings attained by retailers can be passed on to the consumer in the form of even lower prices.¹⁰

The nations' retailers have also been partly responsible for drastically reducing, if not eliminating altogether, consumer loyalty. Merchandise overlap, increased choice and the similarity of store concepts has blurred the distinction between retailers and led to "cross shopping", or consumer infidelity. The slowdown in consumer spending has essentially made the retail industry a "zero-sum" game: retailers competing for a fixed amount of consumer expenditure must attract customers from other stores in order to grow.

Retail Technology

Limited industry growth and declining profit margins have pushed retailers to implement efficiency measures as a means of increasing productivity. Indeed, for most retailers,

increased competition has forced this action to be taken as a matter of survival. Most of the efficiency measures are geared toward streamlining the transportation and holding of merchandise, from manufacturer to point-of-sale. A number of advances in retail technology have enabled retailers to improve merchandise flow and reduce inventory. Reducing inventory levels lowers working capital requirements, for inventory traditionally represents more than half of a retailer's assets.

Advanced retail technological innovations that are being used include scanning systems. Scanners that read bar codes have been in use for years in supermarkets. Now, however, they are increasingly being used by discount and department stores. Most retailers are also now using sophisticated point-of-sale (POS) systems for daily inventory monitoring, and Direct Product Profitability (DPP) systems, commonly employed by supermarkets and discount stores, allow the true profit contribution of each good sold to be instantaneously measured. While the cost of these systems is falling, it has generally been the larger chains who have had the necessary financial resources to fully capitalize on this modern technology.

Some large retail chains, like J.C. Penney and Wal-Mart, have installed electronic communications networks that transmit POS and stock level data to manufacturers. Both the manufacturer
and retailer gain from these networks: the manufacturer receives data that can be used to more accurately plan production levels, which, in turn, lowers production costs and the ultimate cost to the retailer. This system also reduces the lead time it takes to order merchandise, allowing for reduced inventory levels.

Technological retail systems also benefit the consumer. These systems ensure that stores will have the selection of merchandise desired by the customer. In addition, to remain competitive, retailers pass along the savings derived from the systems to the consumer in the form of lower prices.
II. TYPES OF RETAILERS

In recent years the retail marketplace has experienced considerable structural change brought about largely by technological innovation, shifting demographics, consumer preferences and shopping habits, and an anemic economy. These conditions, which were discussed in the previous chapter, have led to the emergence of many relatively new retail formats. Prior to analyzing the performance of specific retailers (this analysis is contained in the next chapter), it is first necessary to clearly define the primary forms or retailers present in the industry; the competing forms of retailers can thus be better understood. This chapter, therefore, presents descriptions of both the newer and traditional primary retail formats including department stores, discount department stores, factory outlets, warehouse clubs/category killers, power centers, shopping centers and non-store retailers.

Department Stores

The traditional department store has long been entrenched in the American lifestyle; once typically single, large, family-owned downtown establishments, these stores are now ubiquitous fixtures in the suburban retail landscape. J.C. Penney, with over 1250 stores in operation, is the nation's largest
department store retailer. Other large department store chains include Dillard's, Macy's and Nordstrom.

According to industry standards, a department store is a retailer that employs at least 50 people and sells minimum amounts of the following items: general apparel; furniture, home furnishings and appliances; televisions and radios; household linens and dry goods. In addition, at least 20 percent of the store sales must come from soft goods and apparel.

Department stores generally form the anchor tenants of regional malls and shopping centers, but can also be freestanding. Department stores typically range from about 50,000 to well over 100,000 square feet of gross leasable area.\(^{11}\)

**New Retailers:**

Due to factors such as the depressed economy and increased consumer product awareness, as discussed in the previous chapter, today's shopper demands value. Consequently, many relatively new forms of value retailers have become prominent.

\(^{11}\)Gross leasable area is all that area for which tenants pay rent; it is the area that produces income. GLA lends itself readily to measurement and comparison. Because of this feature, GLA has been adopted by the retail industry as a standard for statistical comparison.
in the retail marketplace. These consist of discount department stores, outlets and off-price apparel retailers, category killers and warehouse clubs, and are all considered to be "power" retailers. These power retailers feature strong advertising and promotional programs and have achieved success through high-volume, low-markup sales. They have also been successful due to their ability to develop a positive image for value retailing by offering quality merchandise and formats that appeal to all levels of the consumer market.

Discount Department Stores

Foremost among the value retailers are the discount department stores. This segment of the value retailing market contains some of the nation's largest retailers, stores such as Wal-Mart, Kmart, and Target. These large stores, which often have areas of over 100,000 square feet, are generally freestanding or the anchors of strip shopping centers.

Off-price apparel stores also represent a substantial segment of the value market, and include the Marshall's, TJ Maxx and Filene's Basement chains. These stores are considerably smaller than the large discounters, but have been growing to sizes that approach 40,000 to 50,000 square feet.
Outlets

Factory outlets represent another value format that is becoming increasingly common in the nation's retail landscape. While the factory outlet center format being developed today has existed for more than a decade, the concept of a factory outlet store dates back to the last century. Originally, manufacturers located outlet stores adjacent to their plants and sold flawed, unpopular or overproduced merchandise at deeply discounted prices.

Today, the average factory outlet center is approximately 150,000 to 250,000 square feet, but a few are much larger. To be considered an outlet center by the retail industry, 70 percent of the tenants must be manufacturers. Most of these tenants are typically nationally recognized companies such as Polo/Ralph Lauren, Liz Claiborne, Calvin Klein, Nike and Mikasa. While some of these merchants offer factory seconds, most generally sell first quality items at 25 to 40 percent discounts. More are also now selling current-season merchandise in addition to goods leftover from previous seasons.

In 1981 there were only 26 factory outlet malls in the nation. There are now approximately 275 outlet centers in the United
States, with many more planned.\textsuperscript{12}

\textbf{Warehouse Clubs/Category Killers}

Notwithstanding the importance of the retail formats described in the preceding sections, the emergence of two relatively newer types of value retailers, the warehouse clubs and the "category killers", has had the most significant impact on the industry, affecting virtually all other types of retailers.

Both category killers and warehouse clubs are typically described as "big box" retailers. Big box retailers have large store formats, typically over 100,000 of selling space, and generate sales volumes on a square foot basis that are higher than any other type of store. Like the other value retailers, the big box stores operate with low profit margins and use lower cost buildings and lower employee to sales ratios than traditional retailers. Category killers are, furthermore, often able to form direct relationships with manufacturers, enabling them to obtain merchandise at the lowest possible cost. In this manner they are able to offer customers the products they desire at the best prices.

Category killers are stores that offer an exhaustive selection

\textsuperscript{12}Barry Vinocur, "Outlet Centers: Good Bargains for Investors?" \textit{Barron's}, June 14, 1993, p.56.
of merchandise within a specific retail category. Toys "R" Us, Home Depot and Circuit City are definitive examples of the category killer retailer. Warehouse clubs sell a broad range of goods to members who pay a fee for shopping rights. In comparison to the category killers, these stores carry a limited depth of merchandise within any general product type and offer far fewer items than the discount department stores. Warehouse clubs must develop strong membership bases in order to be successful. Costco, Sam's Club, Price Club and Pace are presently the nation's dominant warehouse retailers.13

Power Centers

The success of value retailers in recent years has led to the development of "power centers", or strip centers anchored by category killers and other large value retailers. These centers are further distinguished from traditional shopping centers and malls due to the absence of space devoted to satellite stores; anchor tenants generally occupy most, if not all, of power center gross leasable area.

When power centers were first developed in the mid 1980s, they typically had three or four anchor tenants and had areas of no more than 400,000 square feet. Today, it is not unusual for

13Dean Schwanke, "Navigating the Value Retail Marketplace", Urban Land Institute, May 1993, pp.38-42.
large power centers to reach 750,000 square feet and have seven or more anchor tenants. Some industry analysts believe that centers of up to one million square feet could become commonplace in the near future.  

**Traditional Shopping Centers**

This section contains descriptions of traditional shopping center types. Much of the nation's retail activity takes place in these centers. A discussion of shopping center sales is provided in Chapter III. The descriptions that follow are as defined by the Urban Land Institute.  

"A neighborhood center provides for the sale of convenience goods (foods, drugs and sundries) and personal services (laundry and dry cleaning, barbering, shoe repairing, etc.) for the day-to-day living needs of the immediate neighborhood. It is built around a supermarket as the principle tenant. In theory, the neighborhood center has a typical GLA of 50,000 square feet. In practice, it may range in size from 30,000 to 100,000 square feet. The neighborhood center is the smallest type of shopping center" for which performance data is normally collected.

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"In addition to the convenience goods and personal services of the neighborhood center, a community center provides a wider range of facilities for the sale of soft lines (wearing apparel for men, women and children) and hard lines (hardware and appliances). The community center makes a greater variety of merchandise available - in sizes, styles, colors and prices. It is built around a junior department store, variety store or discount department store as the major tenant, in addition to a supermarket. It does not have a full-line department store, though it may have a strong specialty store. In theory, the typical size is 150,000 square feet of GLA, but in practice it may range in size from 100,000 to 300,000 square feet. The community center is the intermediate type of shopping center; it is the most difficult to estimate for size and pulling power."

"The regional center provides for general merchandise, apparel, furniture and home furnishings in depth and variety, as well as a range of services and recreational facilities. It is built around one or two full-line department stores of generally not less than 100,000 square feet. In theory a typical size for definitive purposes is 400,000 square feet of GLA. The regional center is the second largest type of shopping center. As such, it provides services typical of a business district yet not as extensive as those of the super regional center."
"A super regional center provides for extensive variety in general merchandise, apparel, furniture and home furnishings, as well as a variety of services and recreational facilities. It is built around at least three major department stores of generally not less than 100,000 square feet each. In theory, the typical size of a super regional center is about 750,000 square feet of GLA." In practice, most of the super regional centers developed today have areas well in excess of 1,000,000 square feet.

Non-Store Retailers

One form of retailing that has flourished due to the paucity of spare time and the demand for convenience is non-store shopping. This industry consists primarily of direct response mail-order retailers, television shopping shows and interactive electronic shopping networks. These retailers sell a wide variety of merchandise, from food and apparel to bicycles and electronics.

Catalog mail-order retailers account for most of the non-store industry sales, but the number and popularity of television shopping shows is increasing dramatically. Interactive electronic shopping is, as yet, an underdeveloped retail format, but is projected to rise along with the growing societal use of home computers and the establishment of
communication networks.
III. PERFORMANCE OF RETAILERS

This chapter examines the sales performance of the nation's retailers. The chapter begins by discussing retail sales in broad terms: providing a breakdown of total retail sales by major product category and documenting recent national sales growth. Next, the general types of retailers (chain versus independent) and shopping centers responsible for the greater portion of the nation's sales are discussed. Finally, the chapter examines in greater detail recent sales performance trends for the primary forms of retailers. Retail performance is analyzed within the context of contributing factors such as the capacity of the retailer to adapt to changing consumer preferences, demographics and economic conditions and the ability of the retailer to gain market share in an increasingly competitive retail environment.

It is anticipated that this study of retail performance will provide insight into the ways the retail real estate market will change in the years ahead. The analysis should, for example, enable projections to be made concerning the types of retailers that are likely to perform well in the future and those that are destined to experience declining sales. The implications of projected sales performance for the retail real estate market can then be examined. These implications,
which include factors that must be considered when investment in one of the primary forms of retail stores or centers is contemplated, are discussed in the following chapter.

The national sales and performance data contained in this analysis was largely obtained from Bureau of the Census publications including the "Statistical Abstract of the United States 1992" and the 1982 and 1987 editions of the "Census of Retail Trade". Some general performance data was, additionally, obtained from the current edition of the "Financial & Operating Results of Retail Stores" published by the National Retail Federation.

The performance data for specific retailers contained in this analysis was obtained from corporate annual reports and surveys in the leading industry references. These include publications such as "Chain Store Age Executive", "Discount Merchandiser", "Standard & Poor's Industry Surveys" and "Stores".

In this thesis, retail performance for specific retailers or types of stores is generally examined on the basis of sales per square foot of selling area. Sales per square foot is

16Selling area typically includes clerk and customer aisles, fitting rooms, space contiguous to store entrances, and stockrooms located immediately adjacent to sales departments.
commonly used as a measure of productivity in the retail industry; retailers focus on increasing sales per square foot in order to raise profitability. Sales per square foot is dependent on the price-density of the stock and the "turnover", or number of times per year the stock is sold and replaced.

National Retail Sales Data

Table 3.1 lists national retail sales figures for select years from 1983 to 1992 for the primary categories of goods. As shown in this table, most trade categories experienced substantial growth over the ten year period. However, Table 3.2, which provides total current and constant (using 1987 as a base year) sales figures and annual percentage changes for this period, indicates that the greatest growth occurred in the middle of the 1980s; sales growth slowed significantly at the end of the decade and into the 1990s, and was negative, on a constant dollar basis, from 1990 to 1991.

Chain Store Versus Independent Retailer

The marketplace for most products, both at a national and local level, is dominated by a relatively small number of large merchants; the greater portion of the nation's sales take place in stores owned and operated by large retail chains
### TABLE 3.1
National Retail Sales by Category of Good
($ billions)

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<thead>
<tr>
<th>Category</th>
<th>1983</th>
<th>1986</th>
<th>1989</th>
<th>1992</th>
<th>Annual Growth Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Retail Trade</td>
<td>1,170</td>
<td>1,449</td>
<td>1,762</td>
<td>1,962</td>
<td>5.9</td>
</tr>
<tr>
<td>General Merchandise</td>
<td>136</td>
<td>169</td>
<td>207</td>
<td>247</td>
<td>6.8</td>
</tr>
<tr>
<td>Apparel</td>
<td>60</td>
<td>76</td>
<td>92</td>
<td>105</td>
<td>6.4</td>
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<tr>
<td>Furniture &amp; Appliances</td>
<td>55</td>
<td>76</td>
<td>94</td>
<td>106</td>
<td>7.5</td>
</tr>
<tr>
<td>Miscellaneous Goods</td>
<td>37</td>
<td>48</td>
<td>66</td>
<td>77</td>
<td>8.5</td>
</tr>
<tr>
<td>Automotive</td>
<td>230</td>
<td>326</td>
<td>384</td>
<td>398</td>
<td>6.2</td>
</tr>
<tr>
<td>Gasoline Service Stations</td>
<td>103</td>
<td>102</td>
<td>121</td>
<td>133</td>
<td>2.8</td>
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<tr>
<td>Lumber, Building Materials &amp; Hardware</td>
<td>50</td>
<td>67</td>
<td>81</td>
<td>87</td>
<td>6.3</td>
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<tr>
<td>Eating &amp; Drinking Establishments</td>
<td>113</td>
<td>139</td>
<td>178</td>
<td>202</td>
<td>6.7</td>
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<tr>
<td>Food</td>
<td>256</td>
<td>297</td>
<td>348</td>
<td>384</td>
<td>4.6</td>
</tr>
<tr>
<td>Drug &amp; Proprietary Stores</td>
<td>41</td>
<td>51</td>
<td>63</td>
<td>77</td>
<td>7.3</td>
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<tr>
<td>Liquor Stores</td>
<td>19</td>
<td>20</td>
<td>21</td>
<td>26</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Source: Standard & Poor's Industry Survey
### TABLE 3.2
TOTAL RETAIL TRADE: 1983-1992
($ billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Sales: Current Year $</th>
<th>% Change from Previous Year</th>
<th>Total Sales: 1987 $</th>
<th>% Change from Previous Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>1,170</td>
<td>-</td>
<td>1,342</td>
<td>-</td>
</tr>
<tr>
<td>1984</td>
<td>1,287</td>
<td>10.0</td>
<td>1,414</td>
<td>5.4</td>
</tr>
<tr>
<td>1985</td>
<td>1,375</td>
<td>6.8</td>
<td>1,457</td>
<td>3.0</td>
</tr>
<tr>
<td>1986</td>
<td>1,450</td>
<td>5.5</td>
<td>1,496</td>
<td>2.7</td>
</tr>
<tr>
<td>1987</td>
<td>1,541</td>
<td>6.3</td>
<td>1,541</td>
<td>3.0</td>
</tr>
<tr>
<td>1988</td>
<td>1,658</td>
<td>7.6</td>
<td>1,596</td>
<td>3.6</td>
</tr>
<tr>
<td>1989</td>
<td>1,762</td>
<td>6.3</td>
<td>1,625</td>
<td>1.8</td>
</tr>
<tr>
<td>1990</td>
<td>1,850</td>
<td>5.0</td>
<td>1,639</td>
<td>0.9</td>
</tr>
<tr>
<td>1991</td>
<td>1,865</td>
<td>0.8</td>
<td>1,594</td>
<td>-2.7</td>
</tr>
<tr>
<td>1992</td>
<td>1,962</td>
<td>5.2</td>
<td>1,628</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Source: "Survey of Current Business", U.S. Bureau of Economic Analysis

or in franchises. The nation's top 100 retail chains generated over one-half trillion dollars in sales in 1991, representing more than 25 percent of total sales.\(^{17}\) Small, independently owned retail establishments are, by comparison, estimated to account for less than 20 percent of the nation's

\(^{17}\)David P. Schultz, "The Top 100 Retailers", *Stores*, July 1992, p.34.
The statistics listed below, compiled by the U.S. Department of Commerce for 1987, illustrate the dominance of the retail chain.

- Nationally, a total of 1,076,288 firms operated 1,503,593 retail stores. Over 93 percent of these firms (more than one million) had only one store. These independent stores, however, generated only 43 percent of the nation's total retail sales. Multiestablishment firms, conversely, operated only 33 percent of all stores, but generated 57 percent of total sales.

- Only 487 firms operated retail chains with at least 100 stores, but these stores represented 16 percent of the nation's retail establishments and accounted for 31 percent of sales. These stores also employed 31 percent of the retail work force.

- Chain stores generated an annual average sales total of $1,695,341 at each location, compared to annual sales of only $645,685 for independent stores. Thus, on average, each chain store generated over two and one half times more sales.

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than the independent establishment.

While 1987 is the last year for which the statistics shown above were published\textsuperscript{19}, large retailers have become marginally more dominant over the past decade: In 1980 chains operating 11 or more stores accounted for approximately 37 percent of total national sales. In 1991 this figure was up slightly to about 39 percent. Retail chains, additionally, currently generate over half (around 53 percent) of all nondurable good sales. Automobile purchases comprise the greater share (typically about 56 percent) of durable good sales, and few auto dealers operate at least 11 establishments. Large chains, therefore, account for a relatively low percentage (about 13 percent) of durable good sales.\textsuperscript{20}

Table 3.3 lists the nation's top 50 retailers, ranked according to total sales volume in 1991. The list encompasses many types of retailers including general merchandise stores, supermarkets, drug stores and full-price merchants, but the top two, Wal-Mart and Kmart, are discounters. Together, these

\textsuperscript{19}The Bureau of the Census' "Census of Retail Trade" is published in five year intervals. The 1992 edition has not, however, been issued. The 1987 publication is, therefore, the most current source for certain national retail statistics.

\textsuperscript{20}Chain Store sales figures were obtained from the 1992 Statistical Abstract of the United States, U.S. Department of Commerce, 1993.
### TABLE 3.3
THE NATION'S TOP 50 RETAILERS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Wal-Mart</td>
<td>43,887</td>
<td>1,932</td>
<td>26 Ahold USA¹</td>
<td>5,603</td>
<td>492</td>
</tr>
<tr>
<td>2 K Mart</td>
<td>34,580</td>
<td>4,413</td>
<td>27 Von's Supermarkets</td>
<td>5,350</td>
<td>320</td>
</tr>
<tr>
<td>3 Sears</td>
<td>31,433</td>
<td>1,824</td>
<td>28 Costco</td>
<td>5,215</td>
<td>71</td>
</tr>
<tr>
<td>4 Kroger</td>
<td>21,351</td>
<td>2,231</td>
<td>29 Home Depot</td>
<td>5,137</td>
<td>174</td>
</tr>
<tr>
<td>5 American Stores¹</td>
<td>20,823</td>
<td>1,488</td>
<td>30 Stop &amp; Shop</td>
<td>5,010</td>
<td>247</td>
</tr>
<tr>
<td>6 J.C. Penney</td>
<td>16,201</td>
<td>1,283</td>
<td>31 Dillard</td>
<td>4,036</td>
<td>198</td>
</tr>
<tr>
<td>7 Dayton Hudson</td>
<td>16,115</td>
<td>770</td>
<td>32 Eckerd</td>
<td>3,800</td>
<td>1,675</td>
</tr>
<tr>
<td>8 Safeway Stores</td>
<td>15,119</td>
<td>1,117</td>
<td>33 Rite Aid</td>
<td>3,748</td>
<td>2,796</td>
</tr>
<tr>
<td>9 A&amp;P Supermarkets</td>
<td>11,591</td>
<td>1,238</td>
<td>34 Circle K</td>
<td>3,599</td>
<td>3,700</td>
</tr>
<tr>
<td>10 May Dept. Stores</td>
<td>10,615</td>
<td>3,613</td>
<td>35 Giant Food</td>
<td>3,490</td>
<td>154</td>
</tr>
<tr>
<td>11 Winn-Dixie</td>
<td>10,074</td>
<td>1,207</td>
<td>36 Service Merch.</td>
<td>3,400</td>
<td>359</td>
</tr>
<tr>
<td>12 Woolworth</td>
<td>9,914</td>
<td>8,386</td>
<td>37 Tandy</td>
<td>3,383</td>
<td>7,422</td>
</tr>
<tr>
<td>13 Melville</td>
<td>9,866</td>
<td>8,293</td>
<td>38 Pacific Enterprises</td>
<td>3,300</td>
<td>1,053</td>
</tr>
<tr>
<td>14 Albertsons</td>
<td>8,680</td>
<td>562</td>
<td>39 Nordstrom</td>
<td>3,180</td>
<td>68</td>
</tr>
<tr>
<td>15 Southland²</td>
<td>8,076</td>
<td>6,491</td>
<td>40 Meijer's Thrifty Ac.</td>
<td>3,150</td>
<td>68</td>
</tr>
<tr>
<td>16 Federated Dept.</td>
<td>6,932</td>
<td>220</td>
<td>41 Lowe's</td>
<td>3,056</td>
<td>306</td>
</tr>
<tr>
<td>17 R.H. Macy</td>
<td>6,760</td>
<td>244</td>
<td>42 Grand Union</td>
<td>2,988</td>
<td>304</td>
</tr>
<tr>
<td>18 Walgreen</td>
<td>6,733</td>
<td>1,646</td>
<td>43 Ralphs</td>
<td>2,889</td>
<td>158</td>
</tr>
<tr>
<td>19 Price Club</td>
<td>6,598</td>
<td>58</td>
<td>44 Phar-Mor</td>
<td>2,850</td>
<td>262</td>
</tr>
<tr>
<td>20 Food Lion</td>
<td>6,438</td>
<td>881</td>
<td>45 Ames Dept Stores</td>
<td>2,819</td>
<td>371</td>
</tr>
<tr>
<td>21 Supermarkets Gen.</td>
<td>6,425</td>
<td>220</td>
<td>46 Circuit City</td>
<td>2,790</td>
<td>228</td>
</tr>
<tr>
<td>22 The Limited</td>
<td>6,149</td>
<td>4,194</td>
<td>47 Waban³</td>
<td>2,784</td>
<td>102</td>
</tr>
<tr>
<td>23 Toys &quot;R&quot; Us</td>
<td>6,124</td>
<td>812</td>
<td>48 TJX Cos.⁴</td>
<td>2,758</td>
<td>1,022</td>
</tr>
<tr>
<td>24 Publix</td>
<td>6,100</td>
<td>394</td>
<td>49 Penn Traffic¹</td>
<td>2,730</td>
<td>213</td>
</tr>
<tr>
<td>25 Montgomery Ward</td>
<td>5,630</td>
<td>356</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


1 - These retailers operate supermarket chains.
2 - Operates 7-Eleven and other convenience stores.
3 - Operates HomeBase and BJ’s Wholesale Club.
4 - Operates T.J. Maxx, Hit or Miss and others.
50 retailers generated more than $422 billion in sales, or approximately 23 percent of the nation's sales. Wal-Mart's sales alone account for some 2.4 percent of total sales.

Large retail chains dominate the industry for good reason; they have several advantages over independent stores. The large chains can capitalize on economies of scale, lowering the fixed costs of administration, market analysis and advertising. They also have purchasing power. Major supermarket chains, for example, can negotiate prices with producers who vie for shelf space for their goods. And finally, the large chains have financial resources: they have the capital to modernize stores, the resources to implement the latest cost-reducing technological retailing systems and the means to carry new or unprofitable stores until sales can be increased.21

Chains do have disadvantages. Due to their size and carefully cultivated images they tend to be relatively inflexible; they are less able to rapidly respond to changing market conditions or consumer preferences. Sears, Roebuck & Co. provides a prime example: a decline in Sear's traditional middle-of-the-road customer base in the last decade left them scrambling to counter falling sales. Countless marketing initiatives met with little success as Sears found it difficult to alter its

21Jones and Simmons, The Retail Environment, p.77.
image to appeal to the new consumer. Their latest turnaround effort, a "New Sears" $4 billion renovation initiative, appears to be working; Sears recently posted sales gains that bested all other major retailers. This transformation, was not, however, without injury: Sears had to sell or close many unprofitable operations and stores, and discontinue its 97 year-old catalog business. Sears, for many years the nation's leading retailer, now ranks third and generates total sales that are lower (in real terms) than in its heyday.

To combine the strengths of the chain store and the independent retailer, many large retailers now control a number of different chains that sell separate niche products, often in different locational markets. The Melville Corporation and The Limited are examples of conglomerate retailers that are following this "divide and conquer" strategy to increase market share. The Melville Corporation operates eleven separate chains selling apparel, toys, home furnishings and footwear. These stores include Marshall's, Wilson's Leather, Chess King, Thom McAn, Linens 'N Things and Kay-Bee Toy & Hobby. The Limited operates twelve specialty chains including Structure, Express, Victoria's

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Secret and Lane Bryant. These chains enjoy purchasing power and low administration costs, yet retain flexibility in product lines and store locations. An underperforming outlet can easily be replaced by another type of chain store operated by the same conglomerate. Also, the number of retail locations controlled by the conglomerate gives them the power to negotiate favorable leases with shopping mall developers.

**Franchises**

The business franchise is another form of retailer that accounts for a significant percentage of industry sales. In a franchise, a parent company licenses and sells its trade name and operating systems, but holds some control over the operation of the retail outlet. Featuring standardized decor and uniform product lines, business franchises are outwardly indistinguishable from chain stores.

While automobile dealers and service stations used to be the mainstay of franchising, today the practice is common in virtually every sector of the industry from restaurants and convenience stores to optical shops and computer software outlets. In total, the franchise is used by some 3,000 companies in over 65 fields, with more than 500,000 outlets. The number of new outlets is, additionally, growing at a pace
of over 1,000 per week.\textsuperscript{26}

Franchises have many of the same business advantages as the large chains: they wield purchasing power, have low administrative costs, and wage efficient large-scale advertising campaigns. And like the independent store, the franchise owner/manager has flexibility to adapt to local market conditions. Due in part to these reasons, franchises have performed well in recent years, in sharp contrast to the industry as a whole. From 1990 to 1991, sales through franchised units grew by more than 13 percent. Last year, sales grew by almost 15 percent, and the top 50 retail franchises, excluding automobile dealers, had sales of nearly $40 billion.\textsuperscript{25}

**Shopping Centers**

Much of the nation's retail activity takes place in shopping centers. While shopping centers account for roughly 25 percent of all retail space in the United States, they generate approximately 38 percent of all sales, and about 60 percent of non-automotive sales.\textsuperscript{26} Table 3.4 presents a

\textsuperscript{24}Michael H. Seid, "Franchising Thrives in the '90s", *Stores* (May 1993), p. 70.

\textsuperscript{25}Ibid., pp. 70-71.

\textsuperscript{26}1992 *Statistical Abstract of the United States*, Bureau of the Census.
TABLE 3.4
SHOPPING CENTERS: 1991 RETAIL SALES BY SIZE

<table>
<thead>
<tr>
<th>Type of Center</th>
<th>Gross Leasable Area (SF)</th>
<th>No. Centers</th>
<th>Sales ($ billions)</th>
<th>Percent of Total Retail Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neighborhood</td>
<td>&lt;100,001</td>
<td>23,997</td>
<td>208.3</td>
<td>11.2</td>
</tr>
<tr>
<td>Community</td>
<td>100,001-200,000</td>
<td>9,226</td>
<td>182.2</td>
<td>9.8</td>
</tr>
<tr>
<td>Community/Regional</td>
<td>200,001-400,000</td>
<td>2,953</td>
<td>109.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Regional/Super</td>
<td>400,001-800,000</td>
<td>1,141</td>
<td>93.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Super Regional</td>
<td>800,001-1,000,000</td>
<td>294</td>
<td>45.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Super Regional</td>
<td>&gt;1,000,000</td>
<td>364</td>
<td>78.2</td>
<td>4.2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>37,975</strong></td>
<td><strong>716.9</strong></td>
<td><strong>38.4</strong></td>
<td></td>
</tr>
</tbody>
</table>


breakdown of retail sales by shopping center size. Note that, as shown in the table, a relatively small number of large centers (1,799 centers of over 400,000 GLA) are responsible for more than 11 percent of retail sales. This statistic is another illustration of the extent to which the industry is controlled by relatively few well-capitalized companies, for a high percentage, perhaps 75 to 90 percent, of tenants in the
larger shopping malls are often outlets of the big national chains. This has been the result of the close relationships that have formed between a select group of large shopping center developers and the major retail chains; a large developer can virtually lease an entire new mall by negotiating with only a handful of major retailers. One regional mall that opened recently in the midwest, for example, contains stores - Casual Corner, LensCrafters, Caren Charles, Petite Sophisticate, Ups 'N Downs, Sophisticated Woman, and two shoe stores - from eight of the U.S. Shoe Corporation's divisions.

The relationships between developer and major retailer have propelled the rapid growth of both the chain store and shopping center industries in recent years. While the increasing dominance of the chain store has been discussed in a previous section, the number of shopping centers increased to 37,975 in 1991 from 28,496 in 1986, providing an additional 30 percent of gross leasable area.

Although shopping centers are the location of much retail activity, their sales performance, in absolute terms, has diminished in recent years. Table 3.5 provides shopping center growth and sales performance figures for 1986 to 1991. As shown in this table, average sales per square foot in current year dollars remained essentially level at around
TABLE 3.5

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Centers</th>
<th>Total GLA (Mil. SF)</th>
<th>Sales ($ bil.)</th>
<th>Sales/SF (current dollars)</th>
<th>Sales/SF (1987 $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>28,496</td>
<td>3,523</td>
<td>556.5</td>
<td>158</td>
<td>163</td>
</tr>
<tr>
<td>1987</td>
<td>30,641</td>
<td>3,723</td>
<td>602.3</td>
<td>162</td>
<td>162</td>
</tr>
<tr>
<td>1988</td>
<td>32,563</td>
<td>3,947</td>
<td>641.1</td>
<td>162</td>
<td>156</td>
</tr>
<tr>
<td>1989</td>
<td>34,683</td>
<td>4,214</td>
<td>682.8</td>
<td>162</td>
<td>149</td>
</tr>
<tr>
<td>1990</td>
<td>36,515</td>
<td>4,390</td>
<td>706.4</td>
<td>161</td>
<td>143</td>
</tr>
<tr>
<td>1991</td>
<td>37,975</td>
<td>4,586</td>
<td>716.9</td>
<td>156</td>
<td>134</td>
</tr>
</tbody>
</table>

Source: Statistical Abstracts, U.S. Department of Commerce

$160/SF for the period. In real terms (using 1987 dollars as a base), however, sales dropped substantially, from $163/SF in 1986 to $134/SF in 1991 as illustrated in Figure 3.1. Much of the decline can be attributed to shopping center growth over the period that far outweighed real total retail sales growth (which was only 6.6% from 1986 to 1991). The smaller shopping centers were most responsible for this growth, and were most affected by it; fewer big regional malls were constructed due to the relative difficulty in obtaining financing, finding suitable sites and receiving approvals for large projects in
FIGURE 3.1
Shopping Center Sales/SF Versus Number of Centers: 1986-1991

an increasingly restrictive development environment.\textsuperscript{27} The large malls that were constructed tended to fare better for their development entailed more thorough market research.

Another significant factor, in addition to the growth described above, contributed to the decline in shopping center performance. Shopping centers have faced increased competition from successful freestanding retailers like Toys

\textsuperscript{27}From 1986 to 1991, the number of large malls (those with over 800,000 square feet of GLA) increased by only 15% versus growth of 33% for the shopping center industry as a whole.
"R" Us, Wal-Mart and K Mart, who draw shoppers from the malls. Powerful freestanding retailers have particularly hurt the lower-end centers, such as enclosed malls anchored by a Bradlees or Caldor. These centers compete with freestanding discount retailers for value-conscious customers on the basis of price, rather than amenities, but incur the additional expenses associated with enclosed malls. The larger and more upscale malls have, however, not gone unscathed. The loss of business that these malls have experienced is largely due to the declining performance of their department store anchors. Recent department store performance is addressed in the next section.

**Department Stores Versus Specialty Stores and Discounters**

In the 1980s, department stores were vehicles that enabled select individuals to amass great wealth. These individuals, however, were not retailers, but rather lawyers and investment bankers. Department stores, perceived as undervalued and mismanaged, were targets in the frenzy of leveraged buyouts, mergers and acquisitions that took place in the last decade. Consequently, many department stores were left with high debt levels. Highly leveraged retailers are vulnerable, especially when the economy falters and spending is curtailed; after

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interest expenses on high-yielding debt and principle repayment, there is often little working capital available to restock inventory let alone remodel or expand stores.\footnote{Karen J. Sack, "Retailing: Basic Analysis", Standard & Poor's Industry Surveys, June 4, 1992, p. R77.} For this reason, department stores were increasingly unable to compete with the growing number of tightly focused discounters and specialty stores.

Documentation of the resultant decline in department store performance is presented in Table 3.6 and Figure 3.2. Table
### TABLE 3.6
DEPARTMENT STORE VERSUS SPECIALTY STORE

<table>
<thead>
<tr>
<th></th>
<th></th>
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<td>157</td>
<td>144</td>
<td>183</td>
</tr>
<tr>
<td>1982</td>
<td>136</td>
<td>162</td>
<td>155</td>
<td>185</td>
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<tr>
<td>1983</td>
<td>148</td>
<td>170</td>
<td>152</td>
<td>174</td>
</tr>
<tr>
<td>1984</td>
<td>155</td>
<td>170</td>
<td>176</td>
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<tr>
<td>1985</td>
<td>151</td>
<td>160</td>
<td>178</td>
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<tr>
<td>1986</td>
<td>174</td>
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<tr>
<td>1987</td>
<td>141</td>
<td>141</td>
<td>219</td>
<td>219</td>
</tr>
<tr>
<td>1988</td>
<td>152</td>
<td>146</td>
<td>194</td>
<td>187</td>
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<td>1989</td>
<td>169</td>
<td>156</td>
<td>248</td>
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<td>1990</td>
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<tr>
<td>1991</td>
<td>159</td>
<td>136</td>
<td>262</td>
<td>224</td>
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</tbody>
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Sources: National Retail Federation & U.S. Census of Retail Trade

3.6 lists department store sales per square foot (in current year and real terms) versus specialty store sales from 1981-1991. Figure 3.2 graphically portrays the constant dollar sales performance for this period. As shown, department store sales per square foot have fallen, in real terms, significantly from a peak in the middle of the decade. Specialty store sales, in contrast, generally rose throughout the decade to a level that is substantially higher than that of the department store.
The sales performance of the discounters has also increased dramatically in recent years, especially in relation to the department stores. In 1978, for example, discount stores had average sales per square foot (in current year dollars) of $86 compared with $103 for the department stores. By 1987, however, discount store performance had increased by over 100 percent (unadjusted for inflation) to $177 per square foot versus a gain of only about 37 percent to $141 for department stores.\textsuperscript{30} In recent years, the discount stores have had average sales levels of a little over $200 per square foot, as illustrated in Figure 3.3.

\textbf{FIGURE 3.3}
\textit{1991 Sales/SF for Various Retail Types}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure33.png}
\caption{1991 Sales/SF for Various Retail Types}
\end{figure}

\textsuperscript{30}These sales figures were compiled by the International Mass Retail Association.
Figure 3.4 provides the 1992 sales per square foot for a number of the nation's major retailers. All of the primary retail formats - the category killer, warehouse club, department store, specialty store and discounter - are represented. Figure 3.5 presents the recent sales performance figures of four successful retailers with different retail formats. The sales data contained in Figures 3.3, 3.4 and 3.5 help illustrate some significant industry trends and successful retail strategies. These are discussed below.

- There is a wide gap in sales performance between the top and bottom retailers. Power retailers of all formats - category killers, warehouse clubs and major discounters - typically generate very high sales levels and substantial profit margins. The performance of the warehouse clubs, the industry leaders in area sales volume, has, however, recently slowed dramatically after years of rapid growth. This has been largely due to increased competition from other clubs in increasingly saturated markets. The warehouse clubs must, consequently, look to compete on grounds other than price. Home Depot, a category killer, has, for example, performed well by providing knowledgeable sales help in addition to low prices and extensive selection.
FIGURE 3.4
1992 Sales/SF for Selected Retailers

Costco  
Price Club  
Home Depot  
J.C. Penney  
May Dept. Stores  
Nordstrom  
Kmart  
Wal-Mart  
The Limited  
The Gap

* Estimate based on annual corporate reports and industry surveys

Source: Corporate Annual Reports

FIGURE 3.5
Sales Performance Trends for Selected Retailers


Walmart  
Home Depot  
The Limited  
Nordstrom

Source: Annual Corporate Reports
Many specialty retailers are generating high area sales volumes in difficult market sectors. Retailers like The Gap and The Limited are performing impressively in the apparel industry—an industry that requires quick response to ever-changing fashion demands. These two retailers have been successful with aggressive strategies that include exhaustive market research, test marketing and rapid apparel collection turnover. The Limited also features one of the most efficient systems for planning, purchasing and distributing merchandise in the industry. It has developed manufacturing facilities in the Far East and owns an airplane for merchandise transport.31

Some department stores are making comebacks. The consolidation and restructuring induced by the merger and acquisitions of the '80s, a poor economy and competition from discount and specialty stores, have left several of the major department stores with streamlined operations. Consolidated companies like Dillard's, May Department Stores and Dayton Hudson have implemented the latest retail technology to cut costs and are regaining customers

with creative and sophisticated fashion and value promotions. These stores, however, still have a long way to go, and there is a clear distinction between these select, well-capitalized and well-managed stores and the average department stores; sales figures compiled by the National Retail Federation, for example, show that in 1990 the "high-profit"\(^{32}\) department stores had 28 percent higher sales per square foot than the average ones.

Non-Store Retailers

Non-store retailing has doubled in size over the past 15 years to become over a $53 billion a year industry. The catalog shopping business generates about $51 billion of the industry sales, with the television home shopping networks responsible for virtually all of the rest, some $2.2 billion a year. The Home Shopping Network started the television retail industry in 1985. This network, along with the QVC Network Inc., account for 99 percent of the industry sales; in 1992 the Home Shopping Network had sales of $1.10 billion and the QVC

\(^{32}\)The National Retail Federation defines high-profit department stores as those with profit margins in the top half of the 65 member group they surveyed. The survey results are contained in their "Financial & Operating Results of Retail Stores in 1990" publication.
Network had sales of $1.07 billion.\textsuperscript{33} These two dominant television retailers are presently considering a merger.

Although the television home shopping networks generate but a small fraction of total retail sales, these networks could have an enormous impact on the retail industry in the next century. While much of the merchandise currently pitched by these networks has been kitschy jewelry, gadgets and baubles, they are moving rapidly towards becoming an outlet for mainstream consumer goods. Many upscale retailers are rapidly entering or testing the market. The R.H. Macy Co. will soon have a 24-hour cable shopping channel, and other high-end department stores like Nordstrom's and Bloomingdale's are interested in developing shopping programs. Saks Fifth Avenue has already bought time on the QVC network and stores like J. Crew are negotiating for selling shows.

The television shopping shows offer consumers unparalled convenience and offer retailers a way to dramatically expand their customer base far beyond that allowed by traditional retail methods; the Home Shopping and QVC Networks reached 60 million and 47 million homes, respectively, in 1992.\textsuperscript{34} This audience reach will increase as new communications networks


\textsuperscript{34}Ibid., p.D1.
and more shopping shows are developed. Consumer convenience will also increase as computer technology and telecommunications networks that enable interactive television are perfected and become widely available. Interactive television will allow shoppers to place orders for goods and services directly through their televisions, 24 hours a day. But more importantly, interactive television will make home-shopping efficient. Now, viewers must wait as an endless stream of products is slowly paraded on the screen. In the future, shoppers will be able to scan through merchandise menus to obtain information about a desired product with the touch of a button.

Once the technology and communications networks for interactive television are fully developed, possibly soon after the middle of the decade, this shopping medium could have a tremendous affect on segments of the conventional retail industry. Some industry analysts, like R. Fulton Macdonald, president of International Business Development Corp. in New York, predict that in two decades half of all consumer goods will be purchased via television. Whether or not this prediction proves to be accurate, it seems clear that many retailers that are presently familiar fixtures in the nation's retail landscape might disappear in the near

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future. Pay-per-view systems that enable viewers to order and receive movies directly, rather that renting them from local video stores, will, for example, become more widely available. As such, stores like Blockbuster Video, a retail franchise with over 3,000 stores and total sales in 1992 of nearly $2 billion, might soon be obsolete.
IV. Implications for Real Estate Investment

This final chapter first presents predictions for the industry in near future. The chapter then concludes by discussing issues that should be considered when investing in retail properties given the state of the retail environment.

Predictions for the Retail Industry

Based upon examination of the economic, demographic and consumer preference trends contained in Chapter I and the performance of the major retailers in Chapter III, a number of predictions for the industry can be concluded. These predictions, summarized below, are discussed in this section.

- The industry will further consolidate as fewer well-capitalized, technologically sophisticated and savvy retailers gain greater market share.

- Power retailers will continue to perform well. Their success will further drive the development of power centers.

- The traditional department store format is becoming obsolete as the average department stores will
continue to lose sales to specialty stores and discounters. Those that are to be economically viable must evolve, as some of the top tier department stores have, into more efficient competitors that are more responsive to customer demands.

- Regional centers have lost traffic to power retailers, and few new malls will be developed. Most centers will continue to experience tough competition, and only the well-positioned ones will remain profitable.

The impressive performance of power retailers of all formats - category killers, warehouse clubs and major discounters - should generally continue as powerful competitors, retailers like Wal-Mart, Home Depot and Toys "R" Us, continue to expand into markets containing small regional chains and "mom & pop" stores; these undercapitalized stores offer little competition to the power retailers. In the 1980s about 30 percent of the nation's retailers went out of business. Some industry analysts predict that as many as half of today's retailers will no longer exist at the turn of the century, as the increasingly powerful retailers squeeze out their smaller and
less efficient competitors. While this prediction seems overly dire, it seems clear that the industry will continue to be controlled by fewer and fewer large, well-capitalized and efficient retailers. The variety and complexity of retail formats within the industry should, however, continue to increase.

The traditional department stores will continue to struggle. These stores cannot compete with the category killers in the sale of merchandise such as hardware, electronics and appliances. Furthermore, the sales of these hard line items (with the exception of furnishings and equipment for home offices) are projected to grow at historically slow rates due to reduced household formation and lower housing turnover.

The department stores that will survive must become leaner and meaner. J.C. Penney's has, for example, managed to compete by evolving from a traditional department store to a fashion department store. With prime locations and established names, the top tier department stores like Dillard's and Nordstrom have employed the latest technology and proactive retail strategies to meet the challenges imposed by the specialists and power retailers. Dillard's has one of the best

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37 "After the Dust Settles: Retailing in the 1990s", Chain Store Age Executive, August 1992, p.11.
information systems in the industry. In addition, as the largest customer of almost all of its major suppliers, Dillard's wields substantial buying power.\textsuperscript{38} Nordstrom is a strong department store that has been able to expand and generate high sales volumes (Figure 3.5) in recent years despite the difficult retail environment.

Regional malls will face increasing competition due to the continued development of power centers and the conversion of aging malls into these centers. Only the established malls should perform satisfactorily. Regional mall performance is, of course, largely dependent on the success of the anchor department stores, but established malls have one distinct advantage over the power centers: they control the best suburban locations, and consumer wealth and spending remains concentrated in the suburbs.

Many industry analysts believe the regional malls have other significant advantages over power centers and stand-alone specialty stores. They contend, for example, that the regional mall is firmly entrenched in the American lifestyle: today's young shoppers have grown up with the malls and will continue to frequent them. They also maintain that the malls, with their promotional activities, food courts and movie theaters, are best suited to provide exciting and entertaining

\textsuperscript{38}Donald J. Stone, "Mass Merchandising", p.162.
shopping environments. While these contentions may be true, young shoppers, as discussed in Chapter I, represent a decreasing percentage of the population. These shoppers, furthermore, have much less money to spend than their older counterparts. Also, given time constraints due the demands of career and family, the older shopper looks for convenience rather than entertainment when shopping.

In response to projections that per capita spending on both durable and nondurable goods should decline, but that expenditure for services will increase, both specialty and department stores will offer more services rather than products. Personal shopping, catering, travel services and tailoring are examples of services that will typically be added as retailers vie for a greater share of consumer expenditure. Stores that do not offer these extras will not only fail to capture a share of consumer service expenditure, but might also lose the business of the hurried customer who is drawn to the convenience of one-stop shopping.

The retail industry will continue to accommodate a multitude of retail strategies: some retailers will compete on price alone; others like Wal-Mart will combine low prices with strong service, while stores such as Nordstroms will offer service and exclusive merchandise. But whatever the strategy, the retailers that are to succeed must:
- invest in technology;
- exploit a niche;
- thoroughly understand their customers;
- make shopping enjoyable; and
- be convenient.

The sales volume of non-store retailing will continue to grow dramatically. But because this segment of retailing accounts for such a small percentage total trade, it should not have a significant effect on the industry as a whole in the near future. However, as previously discussed, certain retailers, like video stores, will be threatened.

**Investment Considerations**

The recent sales data for the various retailers contained in Chapter III indicate that high performance is not limited to one retail format; the warehouse clubs may generate the greatest area sale volumes, but top tier department stores like Nordstroms and specialty stores like The Limited and The Gap have performed well, and should continue to do so. Consequently, retail investment should not be confined to the retail forms with the greatest sales volumes. Also, these retailers do not always provide the highest investment return. Furthermore, real estate portfolios are best assembled using the concepts of Modern Portfolio Theory (MPT). In MPT,
properties are selected on the basis of "efficiency": to increase portfolio return while maintaining (or reducing) risk through the acquisition of properties exhibiting divergent return characteristics. Accordingly, in order to achieve true diversification and a portfolio that provides the highest return at the desired level of risk (a portfolio that lies on the "efficient frontier"), a mixture of property types should be obtained. (These properties should, additionally, not be concentrated within the same economic regions.)

In accordance with MPT, most large real estate portfolios contain a combination of office, industrial, retail and residential properties. Few portfolios are, however, fully diversified within these specific property types. The retail properties of several large pension funds, for example, consist solely of regional malls. Although this thesis has illustrated general retail sales trends rather than documenting any specific relationships that might exist between the performance of various retailers and general economic conditions, it is clear that sales by retail type do not necessarily move in tandem with each other or with the economy. Value retailers, for example, are performing well now given the languid economy, but upscale merchants can be expected to prosper in periods of economic boom. As such, to achieve more diversification various types of retail properties should be acquired.
The selection of retail real estate investments must be the result of thorough analysis of not only site-specific property data, but also general industry trends and the dynamics of the particular market segment. The following paragraphs contain a discussion of issues related to retail investment given the present state of the industry, the predictions presented in the previous section, and the sales performance of the various retail formats. The discussion focuses on investment in the primary forms of retail properties including regional malls and power centers.

While the commonplace regional malls should continue to lose customers to the power centers and stand-alone specialty retailers, those that are well-located and feature a mixture of sound tenants can be attractive investments. These select malls are desirable primarily because there are substantial barriers to entry in the regional mall market. Anchors tenants are generally the key to developing new malls, but given the recent difficulties encountered by the department store industry, these traditional regional center anchors are hard to find. Obtaining bank financing for new projects is also difficult, and high equity investment is required. In many regions there is little public money available to help fund necessary infrastructure improvements. Furthermore, in most areas land locationally and physically suitable for development is scarce; if land is available it is usually very
expensive. And finally, with increasingly stringent environmental regulations and public review processes, it can take years to develop a large mall.

In today's retail environment a mall that will be an attractive investment must have the following characteristics:

- Market dominance due to location, size, and strength of the anchor tenants. The anchors should, furthermore, be profitable, have long-term operating covenants, and recently have invested in capital improvements.

- A market area with population, income and personal consumption expenditure levels sufficient to support the center's size and merchandising dynamics.

- To ensure that the locational advantage will be retained there must be substantial local barriers to entry in the market area. These might, for instance, be due to zoning or access constraints.

- The smaller tenants must complement the anchor tenants and provide the regional mall with an overall merchandise selection that fulfills the
expectations of the market constituency. The occupancy costs of the small tenants should also be at or below current market levels.39

As illustrated in Chapter III, category killers and large discounters have been generating high sales and should continue to do so in the future. This does not, however, mean that those who invest in power centers that are made up of these retailers will necessarily earn high returns. A number of factors must be considered when power center investment is contemplated.

Category killers attract customers from considerable distances, but there are limits to this drawing power. For this reason, power centers have traditionally located within close proximity to regional malls. In recent years power center size has increased dramatically for a number of reasons including growth in tenant store format and increasing acceptance of the concept in the lending community. As a result, most sites suitable for power center development (or, as discussed, regional mall development) are at a considerable distance from the prime suburban locations. It is, therefore, increasingly important that the tenant mix create a strong draw. It is, additionally, critical that a thorough

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locational analysis be conducted to ensure that the market area will support the center.

The ratio of small to large tenants in a power center is also an important consideration. When power centers were first developed, the standard community center ratio was followed: approximately 60 percent of the space was devoted to anchors and 40 percent to small stores. This ratio, however, does not work well for power centers: their sparse, elongated strip center designs create long, uncovered distances between stores that discourage cross-shopping. Customers, therefore, tend to shop at only one store per visit, leaving little business for the small, non-destination tenants. As a result, power centers now typically dedicate at least 75 percent of the space to the anchor tenants. The problem for the center owner is that the small tenants, if successful, generate much of the return; the anchor tenants have the clout to negotiate tough leases. The developer/investor must, consequently, carefully consider the tenant ratio: a center with a high percentage of anchor tenants will provide good credit and downside protection, but will limit the upside return potential.40

The past development of power centers adjacent to regional malls has created an abundance of space for small tenants.

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Small tenants, consequently, are in a strong position to negotiate advantageous lease terms. For this reason, investors considering the acquisition of a power center or regional mall must carefully examine the local retail space market conditions to ensure that small tenants will not be lost. The regional mall investor must also consider the nature of the small tenants. Small specialty retailers operated by The Limited have, as discussed in Chapter III, performed very well. There is likely to be less risk of a mall filled with this type of retailer performing poorly, but like the anchor tenants of the power centers, these retailers can negotiate leases that will reduce upside potential.

Conclusion

Change, in retailing as in life, is inevitable. The retail landscape will continue to evolve in response to changing consumer demands, and technological, labor and capital developments. Changes in retailing should benefit the consumer: a greater array of products will be available, at lower real prices, and at greater convenience.

Changes in the retail industry will not, however, necessarily benefit the retail real estate investor. In the projected slow-growth economy, retailers must increase market share, at the expense of their competitors, in order to grow. In this
zero sum environment, there must necessarily be losers; weak retailers will not long remain in business. Caution and thorough research must, consequently, accompany any retail real estate investment. Today's difficult retail market contains many pitfalls and will only provide acceptable returns to the savvy investor who is able to understand the direction the industry is taking.
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