

**From clicks to bricks:
The impact of digital-native consumer brands on retail real estate**
by

Jeffrey Dougherty

B.B.A., Finance, Investment and Banking, 2014
B.B.A., Real Estate and Urban Land Economics, 2014

University of Wisconsin - Madison

Submitted to the Program in Real Estate Development in Conjunction with the Center for Real Estate in
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Signature of Author _____

Center for Real Estate
July 26, 2019

Certified by _____

John Kennedy
Lecturer, MIT Center for Real Estate
Thesis Supervisor

Accepted by _____

Professor Dennis Frenchman
Class of 1922 Professor of Urban Design and Planning,
Director, Center for Real Estate
School of Architecture and Planning

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ABSTRACT

Digital-native retail brands have business models that sit at the intersection of two major narratives in retail: technology and brick-and-mortar stores. Founded online, they rely on technology to attract a Millennial customer base that gets most of their brand information over the internet. Digital-native retailers are also opening, not closing, brick-and-mortar stores at an accelerating pace. Recent studies have suggested that digital-native retail brands will grow from roughly 600 to over 1,400 brick-and-mortar locations in the coming years. However, these projections only consider existing brands, and industry trends suggest that the actual number of physical stores opened by digital-native retail brands will be significantly greater. Real estate owners that develop leasing strategies focused on the specialized needs of digital-native retail brands are positioned to benefit.

The brick-and-mortar store locations of digital-native retail brands provide key insights into their site selection criteria and brand strategies. Store locations are based on customer data from their online stores. As a result, the sites brands select indicate locations with strong target consumer demand. To analyze trends, we identified 58 major digital-native retail brands that have opened a permanent physical store location in the United States. Then, we collected the addresses of the 608 individual stores that they operate. Among other insights, the store location results indicate that digital-native brands concentrate in New York, Los Angeles, and San Francisco before moving into other major metro areas. Within each metro area, digital-native brands agglomerate into both shopping centers and retail streets located within high-income neighborhoods.

Retail property owners have an opportunity to leverage their expertise in physical retail to assist digital-native retail brands in successfully establishing themselves offline. A brand's first few brick-and-mortar locations are a high-stakes bet that falls outside of the company's core competency. Beyond leasing the physical space, landlords can offer support in identifying store locations, completing tenant improvements, and assisting in the store permitting process. Real estate owners and investors that provide low-capital, turnkey spaces and a streamlined leasing process will be attractive to a growing number of digital-native retail brands.

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Chapter 1 – Introduction

In 2019, the casual retail industry observer is flooded with two narratives. The first is a negative narrative surrounding the future of brick-and-mortar retail stores. The second is a narrative on the impact of technology on retail. Here are a few recent headlines.

Narrative 1: “What Retail Recovery? Malls Under Pressure as Stores Close” (Wall Street Journal, April 2019); “U.S. Retail Stores’ Planned Closings Already Exceed 2018 Total” (New York Times, April 2019); “The Empty Storefront Crisis and the End of the American Dream” (New York Times, June 2019); “Retail Stocks’ Punishing Year Just Keeps Getting Worse” (Wall Street Journal, July 2019).

Narrative 2: “Instagram Wants to Be Your Mall” (New York Times, March 2019); “How E-Commerce Sites Manipulate You Into Buying Things You May Not Want” (New York Times, June 2019); “Spurred by Amazon, Supermarkets Try Swapping Cashiers for Cameras” (Wall Street Journal, July 2019); “E-Commerce Turns the Tables on Restaurant Space” (Wall Street Journal, July 2019).

The negative headlines around brick-and-mortar retail are based in facts. In the first six months of 2019, US retailers have announced 20% more store closures than in all of 2018. Through June 2019, 7,062 store closures have been announced relative to 3,022 store openings. That compares to 5,864 store closures and 3,258 store openings in all of 2018 (Coresight Research, 2019). Credit rating agency S&P Global sees more trouble ahead. Their analysis found, “12 of the approximately 136 retailers [S&P] rates would default [in 2019], compared with three a year historically” (Fung, 2019).

A pessimistic retail industry outlook has been reflected in the recent stock market performance of many retailers. Companies in the apparel and department store categories have been especially impacted. “Four of the five worst-performing S&P 500 stocks in the first half of [2019] were retailers” (Otani, 2019). The four companies include Nordstrom, Macy’s, Kohl’s and Gap, whose stock prices fell 1.7%, 1.6%, 1.5%, and 0.6% through the first half of 2019. The S&P 500 gained 17.3% over the same time period.

The headlines around e-commerce are also based in facts. According to the US Census Bureau (2019), e-commerce sales have seen annual double digit growth since the fourth quarter of 2009. Since that time, e-commerce has grown from 4.7% of retail sales to 10.2% as of the first quarter of 2019. UBS equated e-commerce growth with physical store closures. UBS found that, “with each 1% increase in online [retail sales] penetration, some 8,000 to 8,500 stores will need to close” (Daziger, 2019). These numbers equate to roughly 75,000 store closures by 2026 when online retail sales are expected to have 25% market share (Daziger, 2019).

E-commerce combined with shifts in consumer preference is fundamentally changing the retail industry. One large driver of the shift in consumer preferences is attributed to the Millennial age group, born 1981 – 1996. According to Pew Research (2018), these consumers (ages 23 to 38 in 2019) are expected to surpass Baby Boomers as America’s largest living generation in 2019 (Fry, 2018). 73 million Millennials are entering their prime consuming years, and retailers are paying attention.

Retailers are adapting their brands to Millennial preferences. Laurent Freixe, Head of Nestle US and Americas, told the Financial Times, “Local, original, and what [Millennials] can feel and trust are all good. Maybe there is a bit of a reaction to globalization ... Organic, natural, and non-GMO are crystallizing in the US very fast” (Gapper, 2018).

In addition, brands are modifying marketing strategies to reflect how technology is integrated into Millennial consumer habits. In 2013 a Deloitte Ipsos survey, “ranked the Internet as the primary source of new product and brand discovery for the Millennial consumer ... followed by discovery through friends and family” (Hagel et al, 2015). A Ipsos SMX survey (2015) of millennial consumers found, “3 out of 4 reported following official brand or company pages on social media. Of those who have recently discovered a new brand or product online, 78% say they use social media sites as a typical means of discovery, significantly higher than retail sites, forums/blogs or search engines”. Many retail brands have responded to the preference of Millennials to engage with brands online by marketing through social media.

With over 16 million followers on Instagram, fast-fashion brand Fashion Nova is one prominent example of how retail brands are marketing through social media and online. Fashion Nova was established in 2013 and is known for marketing its clothing online through a network of more

than 3,000 influencers and celebrities. In an interview with WWD, founder and CEO Richard Saghian said the company grew by 600% in 2017 (Hughes, 2018). In 2018, Google found Fashion Nova was the most-searched for fashion brand in the United States, ahead of more established brands such as Louis Vuitton (2nd) and Versace (3rd) (Van Elven, 2018).

In addition to Google searches, brands like Fashion Nova often have other advantages over their more established competitors. Digital-native brands may have more flexible-cost structures and emphasize growth over profit margins. Saghian explained to WWD, “A lot of my competitors have teams that work on a budget all day and are obsessed with profit margins ... I don’t want to focus on that right now. I believe that as long as we focus on giving the best product at the best price and getting it to our customer fast, we will continue to grow. Right now the focus is getting as many people onto the platform as possible” (Hughes, 2018). A growth mindset combined with lower fixed costs can provide an advantage to online retailers.

A study from Deloitte explains, “retailers with high fixed-cost structures (due to significant brick-and-mortar assets and inventory costs), which compete using only inventory at hand, are increasingly losing out to competitors with lower fixed-cost structures and extensive product assortments” (Hagel et al, 2015). E-commerce brands have disrupted traditional retail brands through innovative business plans and carefully managing their supply chains. The Deloitte study continues, “Rather than stockpiling inventory, many such retailers fulfill demand only as orders are received. Business models tend to be rooted in few or no brick-and-mortar assets, combined with on-demand fulfillment strategies that help increase consumer value while decreasing total costs (in terms of both price and time)” (Hagel et al, 2015).

Eyeglasses company Warby Parker is one of the most prominent examples of e-commerce companies controlling their supply chains and marketing directly to consumers. Founded in 2010, Warby Parker delivered quality eyewear online at a fraction of the cost competitors were charging. “Its focus on design, customer service and a cultivated quirkiness have become a blueprint of sorts for other consumer brands. Harry’s, the maker of grooming products, shares a co-founder with the eyewear company and was once known as the Warby Parker of shaving. Casper, the mattress seller, was once known as the Warby Parker of sleep” (de la Merced, 2018).

Now valued at about \$1.7 billion, Warby Parker is leading a movement in e-commerce companies opening brick-and-mortar locations (de la Merced, 2018). Per their website, Warby Parker now has 96 brick-and-mortar locations in the United States. Other online retailers are finding value in opening physical locations as well. According to Green Street Advisors, there are approximately 600 brick-and-mortar stores operated by digital-native retailers in the US (Mander, 2018). Real estate services firm JLL expects this number to increase by 850 stores over the next five years (Cook and Taylor, 2018).

Digital-native retailers have business models that sit at the intersection of two major narratives in retail: technology and brick-and-mortar stores. Founded online, they rely on technology to attract a Millennial customer base that gets most of their brand information online. Digital-native retailers are also experimenting with opening, not closing, brick-and-mortar locations. The movement offline indicates their target Millennial customer is interested in experiencing certain brands “IRL” (in real life). The locations digital-native retail brands choose for physical retail stores may provide insight into the most desirable shopping districts, neighborhoods, or streets for Millennial consumers.

Methodology

Very little research has been conducted on the markets and locations digital-native retailers expand into after opening their first location. This study hypothesizes that the brick-and-mortar store location decisions of digital-native retail brands will indicate trends for real estate owners and investors. To test this hypothesis, we used store location data from 58 of the most prominent digital-native retail brands that have opened at least one permanent store location. 608 open store locations in the United States were identified. With the location data, we categorized the stores and analyzed patterns in location selection by the digital-native retail brands.

Thesis Structure

The remainder of this paper is structured as follows. Chapter Two provides a contextual background on the drivers of retail space demand, store location theory, and trends in retail. Chapter Three defines the data being analyzed and the methodology for defining digital-native retailers. Chapter Four discusses the overall results of the analysis and highlights a few key takeaways. Lastly, Chapter Five examines specific conclusions based on the research and explores potential opportunities for future investigation.

Chapter 2 – Context

E-commerce has changed how and where customers buy. Even the most well-established retailers have been impacted. Peter Nordstrom, co-president of Nordstrom, stated at a retail industry summit, “It’s reasonable to assume that we could probably be doing half of our business online in the next five years or so” (Wahba, 2017). It is easy to conclude that brick-and-mortar stores are becoming obsolete. However, in many cases, online and offline sales are not a zero sum game.

Consumers do not view online and offline as independent sales channels. A recent consumer survey found that consumers often consult online sources even when making offline purchases. “Specifically, when asked about their shopping behaviors prior to making a purchase in a physical retail store, 39% of digital consumers visited a brand’s website, 36% read customer reviews, 33% attempted to price match the product online, with 32% finding the brand on Amazon” (Big Commerce, 2018). Physical stores may also improve online sales. Nordstrom found that, “when the chain opens a new store in a market, online sales there get a 20% lift” (Wahba, 2017).

Digital-native retailers provide a unique perspective on the interaction of online and offline retail. Nordstrom developed a website after nearly 100 years of operating physical retail stores (Nordstrom, 2019). In contrast, digital-native brands cultivate an online customer base before ever opening a physical retail location. This section will provide context on the decision process of digital-native retailers when selecting physical store locations. After defining digital-native retailers, we will look at the theory behind retail sales and brick-and-mortar store location.

Digital-Native Retailers

As the name suggests, digital-native brands initially sell their merchandise over the internet. The term, digital-native, is often attributed to Bonobos founder Andy Dunn. According to Dunn (2016), digital native brands embrace an ethos of, “interacting, transacting, and story-telling to consumers is via the web.” Many digital-native brands are also vertically integrated, which allows them to carefully manage their supply chains and brand image. Dunn refers to these companies as digital-native vertical-brands (“DNVB”). He continues, “the name of the brand is

on both the physical product and on the website. The DNVB requires the commercialization of an e-commerce channel, but that channel is an enablement layer—it's not the core asset" (Dunn, 2016). Dunn's last point offers an important insight. Digital native retail companies are building brands online, not simply distributing products through a website.

Building brands online requires customers that are willing to interact over the internet. Dunn (2016) explains, the digital-native brand is, "aimed squarely at millennials and digital natives. It doesn't have to adapt to the future, it is the future. It doesn't need to get younger customers. It starts with younger customers". Dunn's insight is driven by a generational split in online shopping habits. A recent consumer survey revealed, "67% of Millennials and 56% of Gen Xers prefer to search and purchase on ecommerce sites rather than in store. Only 41% of Baby Boomers and 28% of Seniors will click to purchase." 67% of Millennials prefer to shop online compared to 41% of Baby Boomers (Big Commerce & Square, 2017).

The Millennial target customer has defined brand image and marketing strategy for many digital-native brands. Cotopaxi CEO and co-founder Davis Smith explained to Forbes, "The 1980s model of corporate social responsibility was to throw some money at something at the end of the year. Today for most businesses their largest market is Millennials who value experiences more than things. Your product has to tell a story that resonates. You can't just compete on the best technical performance, or make the best backpack anymore. You have to go deeper, and make a human connection that's meaningful" (Taylor, 2017). As a result, digital-native brands have become students of their Millennial customer base. Parachute CEO Ariel Kaye explained Forbes retailing is, "about understand what motivates and drives people to buy, and for [the millennial] group, they really want to purchase something to be part of an overall lifestyle. You want to buy something you love and you probably want to share it, on Instagram and elsewhere" (Hochman, 2016).

Digital-native brands have used their understanding of Millennial shopping habits and branding to compete with traditional retailers. Warby Parker co-founder and co-CEO Neil Blumenthal explained to the Wall Street Journal, "we know more about our customers and can tailor the experience much better than a traditional retailer which doesn't know as much about its customers and might be selling another brand's products" (Safdar, 2017).

Some digital-native brands are bringing their understanding of the Millennial shopper to the brick-and-mortar spaces. The transition from online only to physical retail space has been coined “clicks to bricks”. According to JLL, digital-native brands have expansion plans for 850 new stores over the next five years. Up from about 600 stores as of the end of 2018 (Mander, 2018). Faith Hope Consolo, chairwoman of Prudential Douglas Elliman’s retail division told the Associated Press “Online brands have embraced clicks-to-bricks ... Shoppers love to touch, interact and try on in person” (D’Innocenzio, 2018). However, physical stores were not always in the expansion plans of e-commerce retailers. In 2012, the CEO of online clothing company Everlane told the New York Times, “we are going to shut the company down before we go to physical retail” (Dishman, 2012). Seven years later, Everlane now operates two physical stores in New York and San Francisco. What has changed?

Online retail brands, especially in the clothing, accessories, houseware, and furniture spaces are finding opening stores makes economic sense. These brands are finding customers like to physically engage with their products before making a purchase decision. The furniture retailer Burrow found “Burrow.com’s conversion rate for New York shoppers increased roughly 100%” after opening its flagship store in New York City. In addition, Burrow’s overall sales increased roughly 100% for New York City based customers (Berthene, 2019). Burrow is in the process of expanding their physical presence based on these early results.

Other digital-native retailers have seen similar sales increases after opening a physical location in a new market. Casper CEO Philip Krim told the Wall Street Journal that, “sales have grown more quickly in markets where the company has opened stores” and partially attributed a decline in Casper’s customer acquisitions costs to the success of their brick-and-mortar stores (Safdar, 2018). Women’s lingerie retailer Lively found that physical pop-up stores dramatically increased online transactions. “Lively’s online sales grew by 175 percent in the city of Dallas and 80 percent in the state of Texas” following the opening of a pop-up store in Dallas (Tietjen, 2018). In addition, women’s clothing retailer MM.LaFleur discovered that women who booked appointments at their brick-and-mortar showroom, “often spent up to three times more than online-only shoppers” (Blakely, 2017).

Physical store locations are a function of a brand's understanding of their Millennial target customer. E-commerce retailers utilize data from their online stores to identify the most promising markets for a physical location. As men's clothing retailer Bonobos Chief Revenue Officer Erin Ersenkhal puts it, "Being digitally native, we have the luxury of utilizing data to identify where our biggest customer bases are located" (Bennett, 2017). The brick-and-mortar store locations serve as an extension of the brand's online presence. "Warby Parker, for example, leverages data on its online customers to determine store locations and customize the in-store experience ... and salespeople use tablets to pull up customer purchase history, including which styles they've saved online." (Safdar, 2017).

Retail Theory

Although e-commerce has changed how and where consumers buy, *why* consumers buy remains fundamentally the same. Digital-native retailers are responsive to the same fundamental macroeconomic and demographic trends that impact traditional retailers. The following section reviews drivers of consumer spending and retail store location theory in relation to digital-native retail brands.

Drivers of Consumer Spending

Macroeconomic trends in economic health, income growth, population growth, and savings rates are important factors to consider when evaluating consumer spending. As explained by the CFA Institute, a financial industry trade group, "demand for retail space depends heavily on trends in consumer spending. Consumer spending, in turn, depends on the health of the economy, job growth, population growth, and savings rates" (Fisher and MacGregor, 2012). Each demand factor can be evaluated at either a national or a regional market level. Local demographic information will be important for evaluating brick-and-mortar store locations.

Economic health is often measured by real gross domestic product (GDP) growth, and retail sales are an important component of GDP growth. Stutely (2006) found that a 1% increase in retail sales equated to a 0.3% increase in GDP, all else equal. As a result of the high correlation between retail sales activity and GDP growth, the Federal Reserve Bank of Atlanta projects GDP on an ongoing basis utilizing retail sales as a primary input (Higgins, 2014). The chart below

shows changes in retail sales compared to real GDP growth over time. All else equal, retail space demand should be greater in times of economic expansion and lower in times of economic contraction. Regions with better overall economic health should be preferred for physical retail store locations.

GDP Growth vs. Retail Trade and Food Services Growth



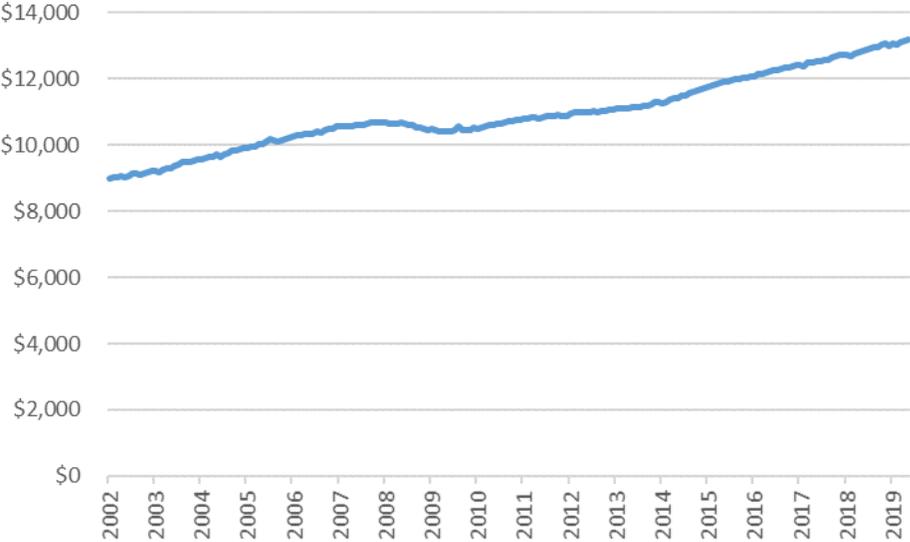
Source: Federal Reserve Economic Data; U.S. Census Bureau

Population and income growth are interrelated factors which impact retail space demand. An increase in either factor will result in more consumer demand for goods. There is a well-established correlation between population size and expected sales (Christaller 1935; Craig et al. 1984; Ingene and Lusch 1980; Ingene and Yu 1981; Kumar and Karande 2000; Reinartz and Kumar 1999). In addition, a foundational concept in economic demand theory finds that as incomes rise, a higher quantity of normal goods will be demanded (OpenStax Economics, 2016). Therefore, there will be greater demand for retail space in areas of high population density or high incomes. The areas of highest retail demand will have strong demographics in terms of both high incomes and high population density.

Lastly, savings rates are the fourth important factor impacting consumer spending. According to the U.S. Department of Commerce, personal consumptions expenditures (PCE) and savings rates can be used to approximate consumer spending. PCE “accounts for about two-thirds of domestic

final spending, and thus it is the primary engine that drives future economic growth. PCE shows how much of the income earned by households is being spent on current consumption as opposed to how much is being saved for future consumption” (Fox et al, 2017). PCE can be used in combination with population and income growth to draw conclusions about consumer spending. All else equal, higher PCE rates will result in greater demand for retail space.

Real Personal Consumption Expenditures (Billions of 2012 Dollars)



Source: Federal Reserve Economic Data

Digital-native retailers benefit from consumer spending in the same way that any other traditional retailer does. Therefore, trends in economic health, income growth, population growth, and savings rates will all impact outcomes. Distilling these trends down to target customer demographics will be most relevant for digital-native retailers. Online-only brands can look at national-level trends, as their product will be delivered by mail. Local demographics will be important to digital-native retailers opening brick-and-mortar stores.

Retail Store Location

Academic research surrounding how traditional retailers select store locations can largely be divided into two categories. The first category looks at the proximity of stores to the target consumer. The Second category looks at the proximity of stores to other stores.

First, stores do better when located near the target customer. Retail location models typically predict stores to locate, “as closely as possible to the consumers demanding their commodity bundle; and to retailers who, by supplying complementary commodity bundles, attract the desired clientele” (Stahl, 1987, 759). Various models focus on either retail centers, consisting of multiple stores, or individual store locations.

A theory termed “retail gravitation” (Reilly, 1931; Huff, 1964) determined that consumers are increasingly attracted to a retail center as center size increases and distance from the consumer’s home decreases. This thought was extended by “central place theory” which implies consumers will select the closest retail center that offers the product sought (Christaller, 1966). Hubbard (1978) further found that consumers minimize travel costs to obtain the products they are seeking.

Empirical evidence indicates that factors outside of travel cost, distance, and retail center size also impact consumer shopping decisions. Gollege et al (1966) and Rushton et al (1967) found that consumers shop for groceries at the closest grocery store less than half of the time.

Consumer preference for individual retail stores has also been widely studied. Consumers typically report that spatial convenience is the most important criteria when selecting a store (Arnold, Ma and Tigert, 1978; Arnold, Oum, and Tigert, 1983). Bell Ho and Tang (1998) found that travel distance from a consumer’s home to the store was an important predictor of store choice. Fox, Montgomery, and Lodish (2004) concluded that consumer spending at grocery, drug, and discount retailers is highly sensitive to travel time.

Second, stores also benefit from being near other stores. Agglomeration of retail stores occurs because it both facilitates consumer search and multipurpose shopping (Fox et al, 2007). Travel time is reduced if consumers can comparison shop between stores or accomplish multiple shopping tasks at one location.

Multiple empirical studies have found evidence of consumer price search between grocery stores (e.g., Carlson and Gieseke, 1983; Urbany, Dickson, Kalapurakal, 1996; Petrevu and Ratchford, 1997). Fox and Hoch (2005) demonstrated that consumers often shop at multiple grocery stores

during one trip. Brown (1989) concluded that similar retailers can increase profits through agglomeration.

Consumers also find value in shopping for multiple items in one trip or “trip-chaining” (Thill and Thomas, 1991). Stores with different products should agglomerate to reduce a consumer’s travel costs between stores (Ghosh, 1986). Arentze, Opewal, and Timmermans (2005) demonstrated that agglomeration increases the desirability of a retail location for both single-item and multi-item shopping trips.

Digital-native retailers will benefit from locating brick-and-mortar stores near their target customers and locating near other stores. This is a conclusion that can also be observed in practice. When deciding to open a store in San Francisco, men’s clothing retailer The Black Tux considered where their customers live and located near other like-minded retail brands. Andrew Blackmon, co-founder of The Black Tux explained to WWD, “We had been looking at San Francisco for a while. It’s one of our more popular markets ... People [there] tend to be early adopters and they care about style and fashion” (Hamanaka, 2017). The Black Tux located their store in San Francisco’s Jackson Square neighborhood next to other trendy brands including Allbirds, Shinola, Fjallraven, Isabel Marant, Theory, and APC.

Retail Industry Trends

Digital-native retailers must also respond to consumer preferences. Consumer preferences are constantly evolving. Retailers must adapt to current preferences or risk falling behind. To remind himself of this fact, Walmart CEO Doug McMillon keeps a photo on his phone of the top 10 retailers in the US by decade. He says the photo helps him maintain a “healthy paranoia” to stay ahead of the competition (Thomas, 2018). Notably, none of the top 10 retailers in 1980 appear on the list in 2017. In addition, Amazon (currently #3) does not appear on the list until 2017. As the photo shows, new retail concepts are continuously emerging. Strong companies of today may be the Sears of tomorrow, and tomorrow’s Walmart may be a company that was nonexistent a short time ago. The following section explores current retail trends applicable to digital-native brands.

Walmart CEO Doug McMillon’s List of Top Retailers by decade

1950	1960	1970	1980	1990	2000	2010	2017
1. Sears	1. Sears	1. Sears	1. Sears	1. Walmart	1. Walmart	1. Walmart	1. Walmart
2. E.J. Korvette	2. Kmart	2. Fortune Brands	2. Kmart	2. Sears	2. Kroger	2. Kroger	2. Kroger
3. Fortune Brands	3. Fortune Brands	3. Kmart	3. Fortune Brands	3. Kmart	3. Sears	3. Target	3. Amazon
4. Kmart	4. Brown Shoe	4. Gibson	4. F.W. Woolworth	4. Kroger	4. Home Depot	4. Walgreens	4. Costco
5. Brown Shoe	5. E.J. Korvette	5. Zayre	5. Target	5. Target	5. Albertsons	5. Home Depot	5. Home Depot
6. Hartmarx	6. Magnavox	6. Brown Shoe	6. E.J. Korvette	6. J.C. Penney	6. American Stores	6. CVS	6. Walgreens
7. Magnavox	7. Hartmarx	7. Woolworth	7. T.G.&Y. Family Centers	7. Target	7. Target	8. Lowe's	7. CVS
8. S&W Fine Foods	8. N/A	8. F.W. Woolworth	8. Walmart	8. Costco	8. J.C. Penney	9. Best Buy	8. Target
9. N/A	9. N/A	9. Two Guys	9. Zayre	9. Super-Valu	9. Costco	10. Sears	9. Lowe's
10. N/A	10. N/A	10. Topps	10. Jewel Osco	10. Home Depot	10. CVS		10. Albertsons

Source: CNBC (Thomas, 2018)

Trends in Brick-and-Mortar Retail

Customer experience has become a point of emphasis for successful brick-and-mortar retail concepts. Fitness apparel retailer Lululemon, which operates over 400 retail locations, considers customer experiences one of the three most important drivers for growth over the next five years. The concept is central to the company’s vision which states Lululemon wants, “to be the experiential brand that ignites a community of people living the sweatlife through sweat, grow and connect.” In a recent press release, CEO Calvin McDonald stated, “We believe Lululemon

has a unique opportunity to ... become a fully experiential brand that creates compelling experiences for guests” (Lululemon, 2019). Lululemon is even referring to its newest store concept in Chicago as the “experiential” store. The 25,000 square foot, three-story space features yoga studios, meditation space, healthy juice and food, and community gathering space.

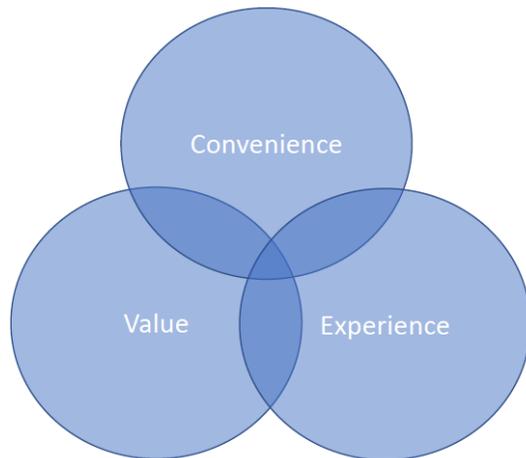
Lululemon is just one example of the focus on experience in retailing. According to the Gartner Customer Experience Survey, 81% of marketers expect customer experience to be the primary area of competition between businesses in 2019 (Pemberton, 2018).

Garrick Brown, Americas Head of Retail Research at real estate services firm Cushman & Wakefield, offers a helpful framework for understanding how experience became a point of emphasis in retail today. Historically, brick-and-mortar retailers could differentiate their product in three areas: value, convenience, or experience (Brown, 2019). Many successful retailers specialized in just one category. For example, 7-11 is a convenience oriented retailer. 7-11 rarely competes on value or experience. However, the internet has challenged the value proposition of many traditional retailers.

E-commerce retailers have a natural advantage in value retailing due to their cost structure. They are often able to deliver identical products to customers at a lower cost by reducing overhead expenses, such as employee salaries, from physical store operations. “For example, Amazon operates at an approximately 15 percent price markup, compared with an average markup of 65 to 80 percent for apparel centric retailers.” (Hagel et al, 2015). Soon, e-commerce retailers may also have the advantage in convenience retailing.

Amazon already offers free same-day delivery in select cities on over three million items (Amazon, 2019). These efforts have started to shift consumer perception of Amazon from value retailer to convenience retailer. According to a recent consumer survey, 28% of respondents ranked convenience as the primary reason to purchase from Amazon. Only 25% of respondents ranked value as the primary reason to purchase from Amazon (Big Commerce, 2018). As package delivery time and cost continues to decrease, convenience will become less of an advantage for brick-and-mortar retailers. The final value proposition for brick-and-mortar retailers is experience. As a result, many traditional retailers are focusing on customer experience to remain competitive.

Retailer Value Proposition Diagram



Source: Cushman & Wakefield (Brown, 2019)

Digital-native brands have noticed the value of experiential brick-and-mortar retail as well.

Warby Parker co-founder and co-chief executive Neil Blumenthal told the Wall Street Journal, “I don’t think retail is dead. Mediocre retail experiences are dead ... While e-commerce has been growing, the majority of retail still happens within four walls.” Warby Parker is known for their digital roots selling eyeglasses online but now operates nearly 100 stores (Warby Parker, 2019).

For digital-native companies, brick-and-mortar stores are often the first chance customers have to interact with brands in real life (often shortened to “IRL”). Customer engagement was the main reason beauty brand Glossier opened its first store in New York City. A Glossier spokesperson explained to Forbes the, “Glossier Flagship is meant to be ‘the ultimate physical expression of the brand’ and a place for customers, ‘to meet Glossier in real life” (Walton, 2018).

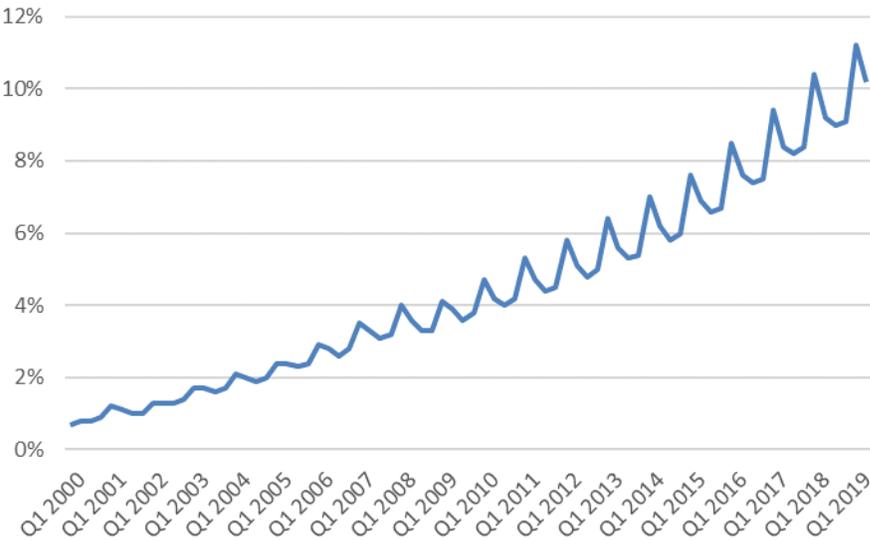
With only two permanent retail locations, Glossier is still experimenting with brick-and-mortar. However, brands like fitness retailer Peloton have embraced physical store experience as a core strategy. Chief Revenue Officer Tim Shannehan explained to True Ventures, “We believe there’s a big advantage when you can connect the emotional and physical and do it in a way that inspires your senses. We also believe consumers expect an opportunity to test your product and envision its place in their life ... the magic happens when you hop on a Bike, put on the headphones, lock into a class, and start riding. Enjoying that experience is very much a part of our brand” (True Ventures, 2018).

Peloton currently has over sixty brick-and-mortar retail locations in the United States. Alongside brands such as Warby Parker, Bonobos, and Untuckit, Peloton has demonstrated the value of physical experience to digital-native brands. The trend may continue as digital brands desire to connect with their customers IRL.

Trends in Online Retail (E-commerce)

Online retail sales keep trending upward. 96% of Americans now shop online for some purchases (PSKF, 2018). According to the US Census Bureau (2019), e-commerce sales have seen annual double digit growth since the fourth quarter of 2009. Since that time, e-commerce has grown from 4.7% of retail sales to 10.2% as of the first quarter of 2019. February 2019 marked the first time online sales were higher than general merchandise stores. The general merchandise category includes department stores, warehouse clubs, and supercenters.

E-Commerce Sales as a Percentage of Total Retail Sales



Source: Retail Indicators Branch, U.S. Census Bureau

Consumers will find online retail more attractive as delivery methods become faster and more convenient. However, online retail does not impact every retail category in the same way. Certain products are easier to compare online while many consumers prefer to physically see other products in person prior to purchasing. Preference undoubtedly varies by person, product,

and situation. Lynch, Kent, and Srinivasan (2001) introduced the concept of “high-touch” products and “low-touch” or “no-touch” products. High-touch products are items such as clothing or food that, “consumers would rather inspect before buying.” Low or non-touch products include items such as books or airline tickets which do not necessarily need to be inspected prior to purchase. Various products may fall at different points along a continuum. Chiang and Dholakia (2003) furthered the discussion and found that online retailers had the advantage when consumers perceived items to be “search goods”, (i.e. a purchase decision can be made by evaluating external information) rather than “experience goods”.

In an effort to further distill which goods sell best online, Hortacsu and Syverson (2015) broke out e-commerce sales as a percentage of product categories. Then, they made projections based on current growth expectations. E-commerce accounted for the largest share of music, video, and book sales. E-commerce accounted for the lowest percentage of clothing, drugs and health, and food and beverage. These findings are consistent with the earlier differentiation between search goods and experience goods.

Product-Specific E-commerce as a Share of Product Total Sales

<i>Product category</i>	<i>E-commerce share of retail sales, 2013</i>	<i>Total retail sales (e-commerce and not), 2013 (\$ billions)</i>	<i>Projected year that product's e-commerce share will be (bold italics means reached in the data already):</i>			
			<i>25 percent</i>	<i>50 percent</i>	<i>75 percent</i>	<i>90 percent</i>
Music and videos	79.6%	\$11.8 B	2005	2009	2012	2016
Books and magazines	44.2%	\$23.9 B	2009	2015	2021	2028
Computer hardware and software	32.9%	\$62.3 B	2006	2017	2028	2038
Toys, hobbies, and games*	28.8%	\$25.5 B	2011	2017	2023	2028
Electronics and appliances	23.1%	\$102.6 B	2013	2017	2021	2026
Furniture	17.5%	\$118.0 B	2016	2022	2028	2035
Office equipment and supplies*	17.3%	\$24.6 B	2014	2020	2026	2032
Sporting goods	16.9%	\$54.1 B	2016	2022	2029	2035
Clothing, accessories, and footwear	14.9%	\$291.1 B	2017	2024	2031	2038
Drugs, health, and beauty	4.7%	\$374.5 B	2028	2037	2045	2054
Food and beverages	0.9%	\$650.9 B	2032	2039	2045	2051

Source: Hortacsu and Syverson (2015)

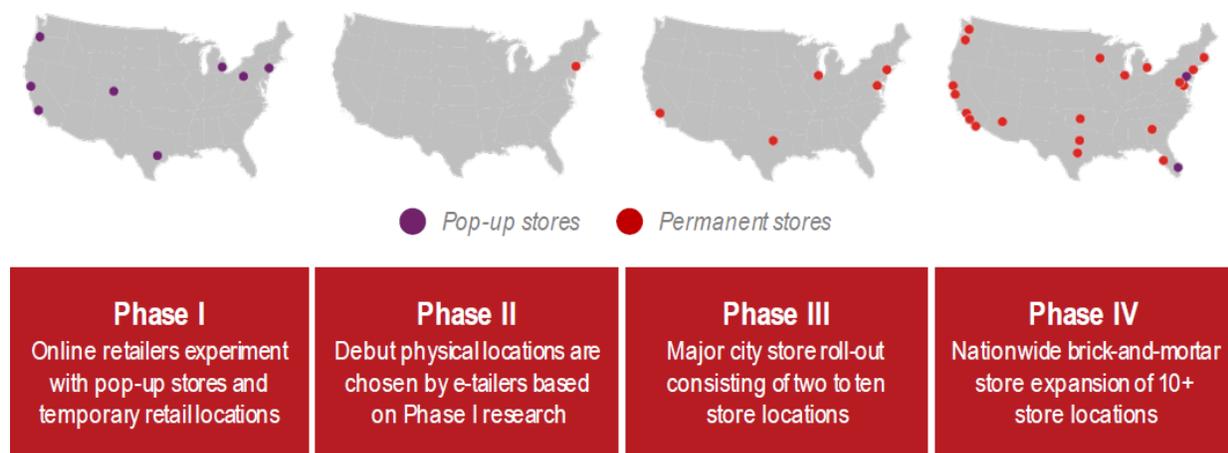
Based on these studies, digital-native brands selling “high-touch” or “experience goods” should be most likely to experiment with brick-and-mortar stores. This conclusion is consistent with data from a JLL research report. JLL found 74% of digital-native retailers with brick-and-mortar locations sell apparel & accessories. The second highest category was furniture, home furnishings, & housewares at 11% (Cook and Coyne, 2018).

Previous Literature

Commercial real estate services firm JLL has conducted the most in-depth research around online retailers opening brick-and-mortar locations. JLL has produced two reports focused on the growth strategy of e-commerce retailers after they decide to open a brick-and-mortar location. The growth strategy consists of four phases, and “clicks-to-bricks retailers are thoughtful in their retail choices, ensuring that physical locations align with brand image and business strategy” (Cook and Einhorn, 2016).

The four phases of physical store roll out are pop-up stores, debut physical location, major city roll-out, and nationwide expansion. In phase I, online retailers test the physical store strategy with temporary pop-up stores. In phase II, a first permanent physical store is selected by the online retailer. In phase III, two to ten permanent stores are rolled-out across the country. The new stores are located in major cities. In phase IV, permanent stores are opened all over the country (Cook and Einhorn, 2016).

Four phases of the clicks-to-bricks lifecycle



Source: JLL (Cook and Einhorn, 2016)

JLL researched the top cities for first pop-up locations and first cities for permanent locations. New York City led both categories with 59.5% of first pop-up locations and 41.3% of first permanent locations. Notably, 62% of permanent stores were opened in the same city as the first

pop-up shop. The SoHo neighborhood of New York is also the top destination for pop-up retailers, accounting for 48% of all first pop-up locations (Cook and Coyne, 2018).

As of 2018, JLL expects e-commerce retailers to open 850 physical stores over the next five years. Major brands include mattress retailer Casper who expects to open 200 stores over the next three years and lingerie retailer Adore Me who announced expansion plans for 300 additional stores over the next five years (Cook and Coyne, 2018).

This paper expands on the research theme initiated by JLL by taking a detailed look at specific ecommerce retailer store locations after the initial store opens. The goal is to identify geographic location and store type trends as retailer progress from opening their first physical store (phase II) to opening stores all over the country (phases III and IV). Trends may indicate the regions, neighborhoods, and/or shopping centers that are best positioned to benefit from the brick-and-mortar expansion plans of online retailers.

Chapter 3 – Data and Methodology

Introduction

The primary hypothesis considered in this study is that the brick-and-mortar store location decisions of digital-native retail brands will provide insights for real estate owners and investors. To test this hypothesis, we used store location data from 58 of the most prominent digital-native retail brands that have opened at least one permanent store location. 608 open store locations in the United States were identified. With the location data, we categorized the stores and analyzed patterns in location selection by the digital-native retail brands.

Data Summary

The first step in gathering data was defining the characteristics of digitally-native retail brands. We started with a list of the top 50 digital native direct-to-consumer brands compiled by The Lead, a fashion and retail industry trade group. Retailers were added or removed based on the following criteria:

Criteria for digitally-native brands:

- Founded as an online retailer
- Operating as a brand. Not just e-commerce distribution channel.
- Opened and currently operating at least one permanent brick-and-mortar store.
- Opened first permanent store location after 2010

Second, the locations of qualifying companies were identified. The base data set used for this study was compiled from individual company websites in June 2019. Qualifying locations met the following criteria:

Criteria for store locations:

- Brick-and-mortar store location operated on a permanent basis directly by the digitally-native brand
- Store located in the United States
- Not Included:

- Temporary pop-up stores
- Partner retailer locations
- Closed stores

Coding Criteria

We next categorized store locations by location type and retail district. The location categories are indoor shopping center, outdoor shopping center, and street.

Shopping center definitions:

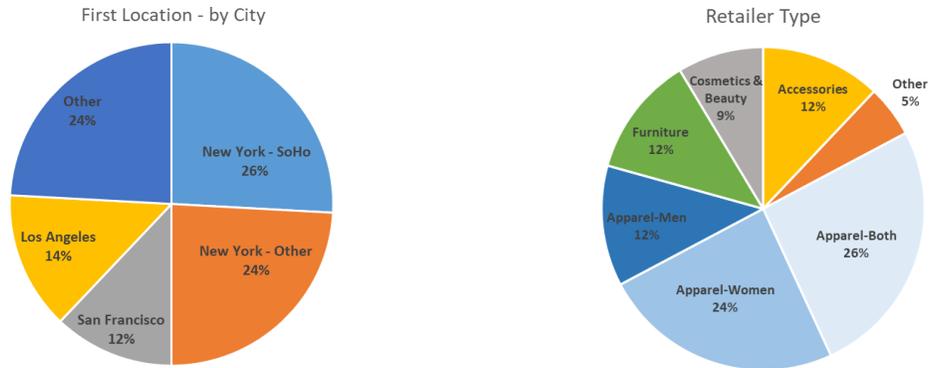
- Indoor shopping center – The shopping center consists of an enclosed structure with inward-facing stores. The stores are connected by a common private walkway and common private parking surrounds the outside perimeter. Typically, these shopping centers are referred to as regional or super-regional malls.
- Outdoor shopping center – The shopping center consist of an open structure with either inward or outward facing stores. The stores are connected by a common private walkway and share common private parking. Typically, these shopping centers are referred to as lifestyle centers, open-air malls, community centers, or strip centers.
- Street – The store does not share a common structure, private walkways, or private parking. Typically, the storefront is accessed directly via the sidewalk. Other references may be street retail, high street retail, or stand-alone stores.

We categorized store locations into retail districts primarily based on location. Stores located in or immediately adjacent to a shopping center were grouped into that shopping center’s retail district. Stores located along streets were grouped into the shopping district commonly associated with their location. For example, stores located within 1-2 blocks of Michigan Avenue in Chicago, IL are all categorized under the Michigan Avenue retail district.

Chapter 4 – Analysis Results and Interpretation

Digital-Native Retailer Data Summary

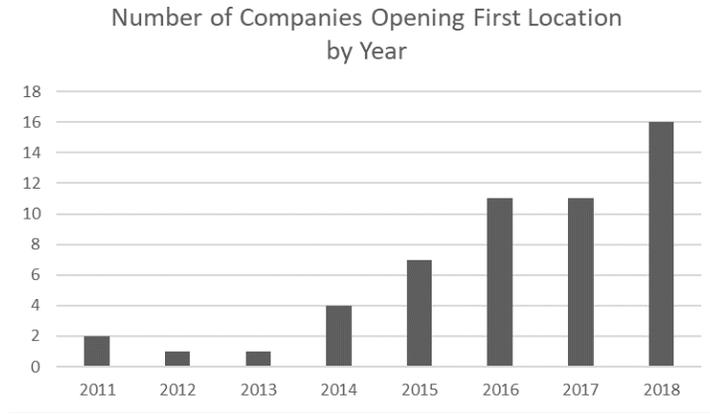
We identified 58 major online retailers that have opened permanent physical store locations in the United States. 608 stores were compiled based on location data available on individual company websites. For comparison to the JLL studies, we also compiled first location and



As the location graph shows, a majority (50%) of digital-native retailers open their first permanent store in New York. Of the New York stores, 50% are in SoHo. These results are very similar to the JLL study which found 41% of retailers select New York for their first permanent store and of the New York stores, 48% are located in SoHo.

The retailer type graph indicates most digital-native retailers that have decided to open physical stores are apparel retailers. 62% of the brand studies sell apparel. Furniture, Accessories (including shoes, handbags, eyewear, etc...), and cosmetics are the other major categories. These findings are again consistent with the most recent JLL study which found 74% of brands were apparel & accessories.

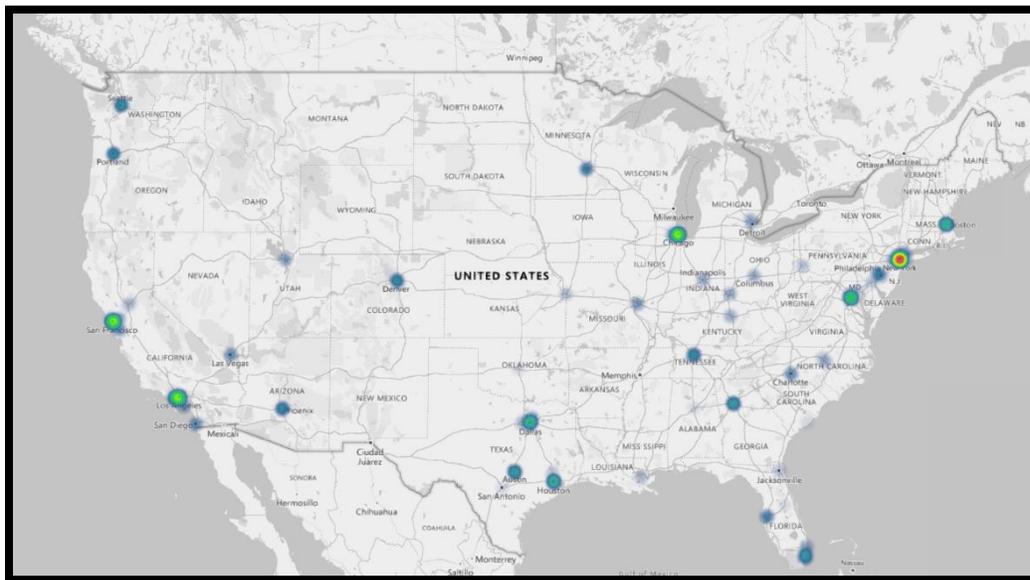
Next, we looked at the year in which the first permanent physical store was opened. A graph of the data is included below. Clearly, there is an increasing number of online retailers exploring brick-and mortar options. Two brands opened stores in 2011 compared to sixteen brands in 2018.



Geographic Analysis

We started analyzing the location data by looking at the geographic distribution of stores by state and metro area. The heat map below visualizes the locations of all 608 brick-and-mortar stores identified. The map indicates stores tend to be located in major metropolitan areas. Cities in the Northeast and California are the dominant locations followed by cities in Texas and Chicago.

Heat Map of Digital-Native Store Locations



The table below showcase the concentrations of digital-native companies locating in costal markets. Illinois and Colorado are the only non-costal states ranking in the top 10. Additionally, California (22%) and New York (14%) are the states of choice. Of the 58 companies studied, 38 (65%) had a location in California and 44 (76%) had a location in New York.

Top 10 States:

Rank	State	# Stores	% of Total
1	CA	134	22%
2	NY	84	14%
3	TX	56	9%
4	IL	40	7%
5	FL	36	6%
6	MA	21	3%
7	NJ	19	3%
8	CO	13	2%
9	PA	13	2%
10	GA	13	2%
Top 10 Subtotal		429	71%
Other		179	29%
Total		608	100%

The top 10 metro areas again showcase the preference of digitally-native retailers for costal and gateway markets. New York, Los Angeles, and San Francisco make up the top 36% of brick-and-mortar store locations. Chicago is the top non-costal city with 40 locations (7% of the total).

Top 10 Metro Areas:

Rank	Metro Area	# Stores	% of Total
1	New York Area	102	17%
2	Los Angeles Area	69	11%
3	San Francisco Bay Area	49	8%
4	Chicago Area	40	7%
5	Washington D.C. Area	30	5%
6	Dallas/ Fort Worth Area	24	4%
7	Miami / Ft Lauderdale	21	3%
8	Boston Area	19	3%
9	Houston Area	18	3%
10	Atlanta Area	13	2%
Top 10 Subtotal		385	63%
Other		223	37%
Total		608	100%

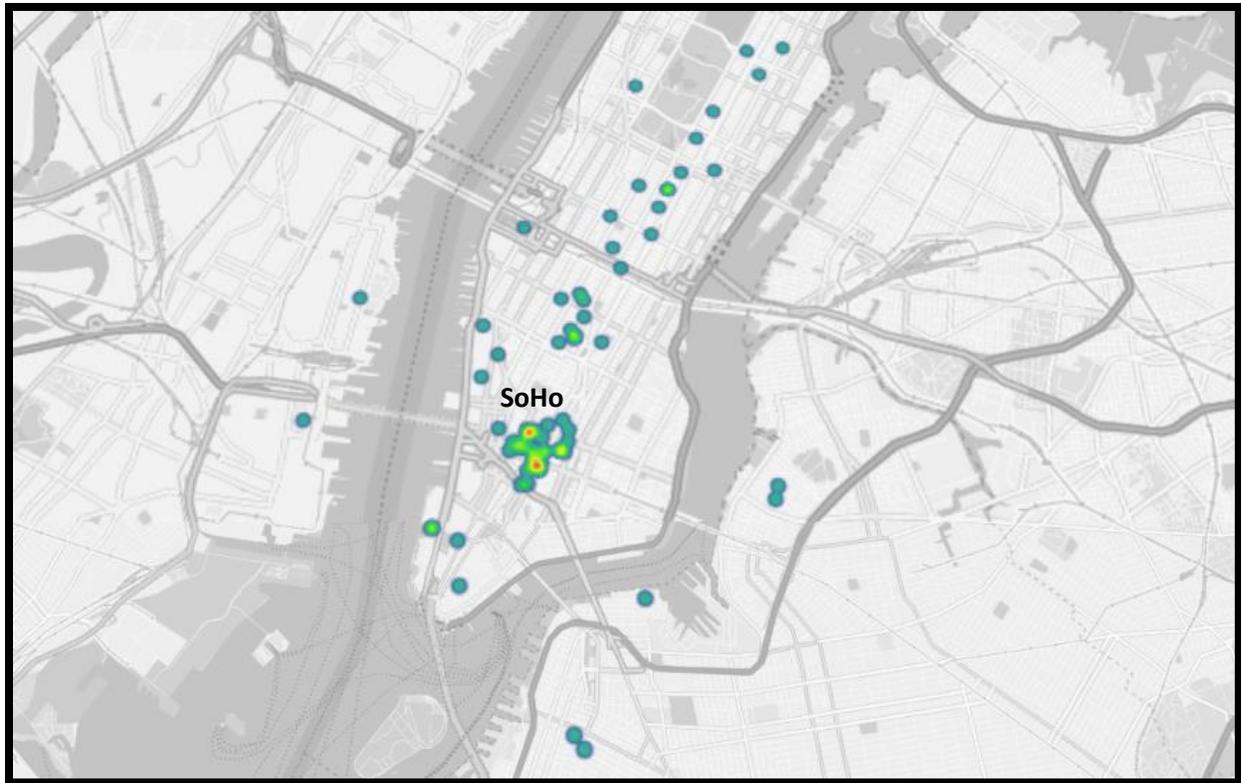
Top 10 Retail Districts:

Rank	Retail District	City	# Stores	% of Total
1	SoHo	New York	30	6%
2	Westheimer Road / The Galleria	Houston	10	2%
3	Melrose Avenue	Los Angeles	9	2%
4	West Armitage	Chicago	9	2%
5	Michigan Avenue	Chicago	9	2%
6	Union Square	San Francisco	8	2%
7	The Domain	Austin	8	2%
8	M Street	Washington	8	2%
	Cherry Creek Shopping Center &			
9	Fillmore St	Denver	8	2%
10	Newbury Street	Boston	8	2%
Top 10 Subtotal			107	23%
Other			360	77%
Total			467	100%

Store Concentrations

We next looked at concentrations of digital native retailers within metro areas and cities. For example, the SoHo neighborhood in New York is the must-be destination for digitally native. 30 of 58 (52%) companies studied have at least one location in SoHo.

Heat Map of Digital-Native Retail Locations in New York City



SoHo is the dominant neighborhood for digital-native retailers located in the New York Metro area. Of 102 stores in the New York Metro Area, 30 stores (29%) are located in SoHo. We studied all other metro areas with at least one store to determine if a pattern emerged in store concentrations.

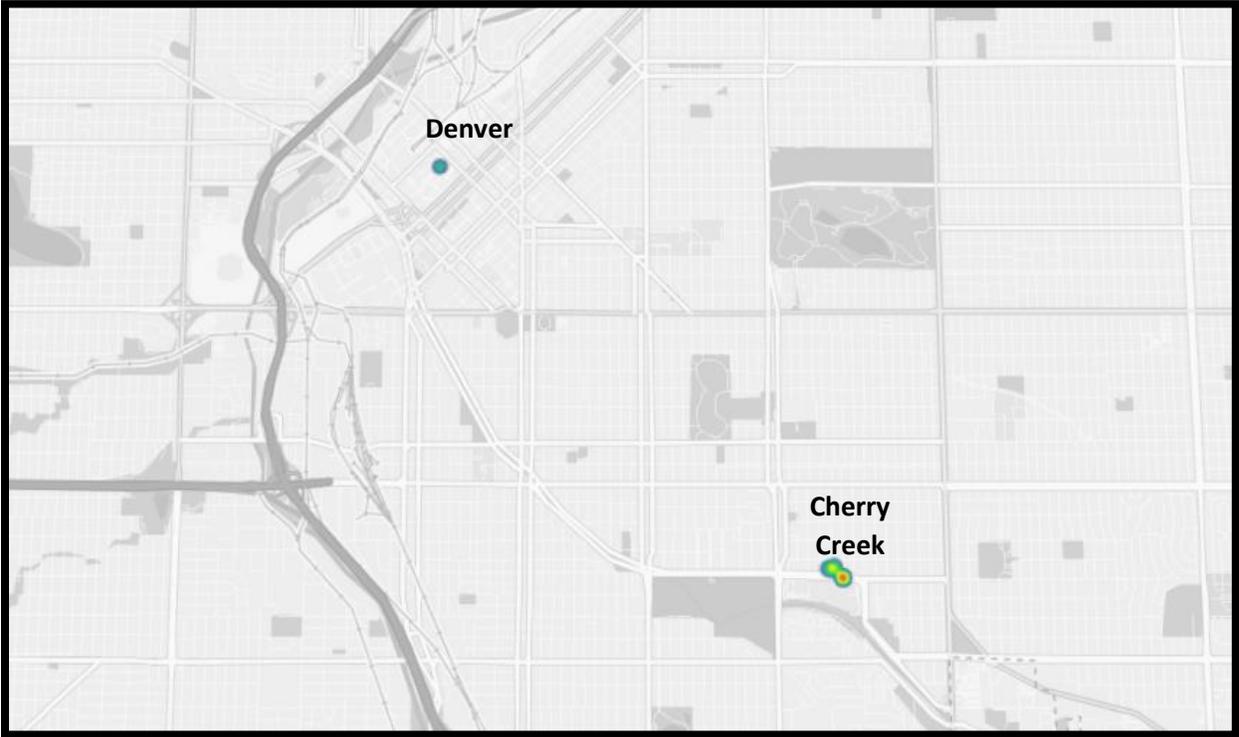
Visually, it appears that digital-native retailers will concentrate on a specific street or within a specific mall. In Chicago for example, 60% of stores are located in three locations: West Armitage Avenue, Michigan Avenue, or Oakbrook Center. In Denver, 73% of stores are located in and around the Cherry Creek Shopping Center.

Statistically, we measured the concentration of stores within each metro area by calculating the correlation between number of stores in a metro area and the percent of total metro stores located within the top retail district. There is a strong negative correlation (-0.649) between the number of stores in a metro area and the percent concentration of stores located within the top retail district. If New York is removed as an outlier, the negative correlation increases to -0.742. These correlation results indicate that metros with a smaller number of stores will be more concentrated. At least initially, digital-native retailers tend to locate their stores near other digital-native retailers.

Heat Map of Digital-Native Retail Locations in Chicago



Heat Map of Digital-Native Retail Locations in Denver



Top Store Concentrations by Metro Area

Metro Area		Retail District		Concentration
Metro	# of Stores	Retail District	# of Stores	
New York	102	SoHo	30	29%
Houston	18	Westheimer Road / The Galleria	10	56%
Los Angeles	69	Melrose Avenue	9	13%
Chicago	40	West Armitage	9	23%
San Francisco Bay Area	49	Union Square	8	16%
Austin	11	The Domain	8	73%
Washington	30	M Street	8	27%
Denver	11	Cherry Creek Shopping Center & Filmore St	8	73%
Boston	19	Newbury Street	8	42%
Minneapolis	10	Mall of America	7	70%
Philadelphia	11	King of Prussia Mall	6	55%
Atlanta	13	Lenox Square	6	46%
San Diego	8	Westfield UTC	6	75%
Scottsdale	10	Scottsdale Fashion Square	6	60%
Dallas/ Fort Worth	24	Legacy West	5	21%
Miami / Ft Lauderdale	21	Aventura Mall	5	24%
Seattle	12	Bellevue Square	5	42%
Tampa	7	International Plaza	5	71%
Portland	11	Washington Square Mall	5	45%
Charlotte	6	Southpark Mall	5	83%
Nashville	10	The Mall at Green Hills	5	50%
Indianapolis	4	The Fashion Mall at Keystone	4	100%
Lexington	4	Fritz Farm	4	100%
Detroit	7	Somerset Collection	4	57%
Raleigh - Durham	6	The Streets at Southpoint	3	50%
St. Louis	5	Plaza Frontenac	3	60%
Salt Lake City	6	City Creek Center	3	50%
Las Vegas	6	Fashion Show	3	50%
New Orleans	3	Magazine Street	3	100%
Jacksonville	3	St Johns Town Center	3	100%
Kansas City	3	Country Club Plaza	3	100%
Columbus	4	Easton Town Center	3	75%
Cincinnati	4	Kenwood Towne Centre	3	75%
Oklahoma City	2	Classen Curve	2	100%
Baltimore	2	Aliceanna Street	2	100%
Sacramento	6	The Ice Blocks	2	33%
Columbia	2	The Mall in Columbia	2	100%
San Antonio	2	The Shops at La Cantera	2	100%
Hartford	2	Westfarms	2	100%
Pittsburgh	3	Penn Avenue	2	67%
Charleston	2	King Street	2	100%
Dedham	2	Legacy Place	2	100%

Demographics

We next reviewed demographic information on the top retail districts to check for trends between locations. A clear pattern emerged for average household income and educational attainment.

Retail districts with at least six stores were located in high-income, high-education neighborhoods. The median household income in the 22 locations studied is \$103,478 compared to the US median household income of \$59,039. In the median location, 61% of adults over 25 had obtained at least a bachelor's degree compared to the US average of 34%.

Average household income and education level of retail districts with at least 6 digital-native stores

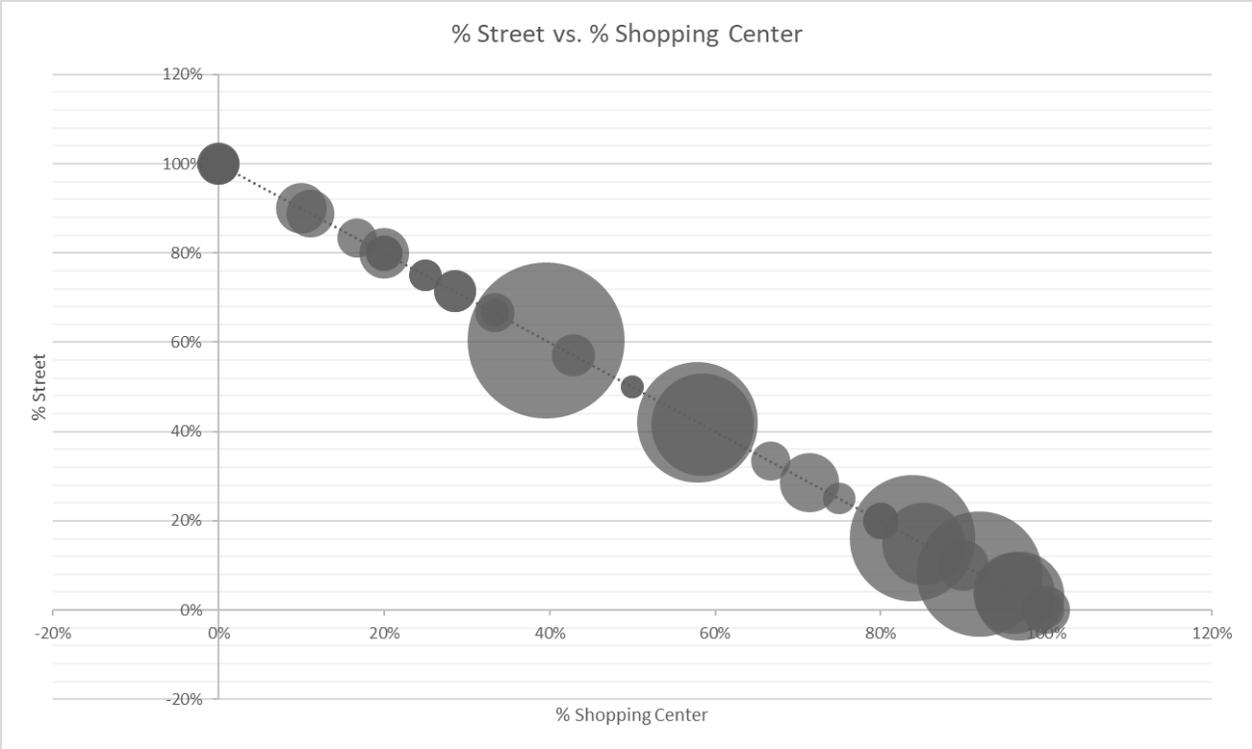
Rank	Retail District	City	Neighborhood	Average Household Income			Education (% Bachelor or Above)		
				Neighborhood	City/State Avg.	% above/below	Neighborhood	City/State Avg.	% above/below
1	SoHo	New York	SoHo	\$124,396	\$58,856	111%	70%	37%	89%
2	Westheimer Road / The Galleria	Houston	Uptown (Galleria)	\$138,918	\$47,793	191%	60%	32%	85%
3	Melrose Avenue	Los Angeles	West Hollywood West	\$84,303	\$54,432	55%	61%	33%	84%
4	West Armitage	Chicago	Lincoln Park	\$110,867	\$53,006	109%	69%	39%	79%
5	Michigan Avenue	Chicago	Magnificent Mile	\$96,857	\$53,006	83%	74%	39%	92%
6	Union Square	San Francisco	Union Square	\$56,401	\$103,801	-46%	44%	57%	-23%
7	The Domain	Austin	North Burnet	\$58,498	\$66,697	-12%	32%	49%	-35%
8	M Street	Washington	Georgetown	\$128,591	\$75,506	70%	64%	57%	12%
9	Cherry Creek Shopping Center	Denver	Cherry Creek	\$133,015	\$61,105	118%	60%	50%	21%
10	Newbury Street	Boston	Back Bay	\$117,041	\$63,621	84%	71%	48%	48%
11	Tyson Corner Mall	McLean	McLean, VA	\$192,568	\$68,114	183%	83%	38%	118%
12	Westfield Garden State Plaza	Paramus	Paramus, NJ	\$107,770	\$76,126	42%	48%	39%	24%
13	Mall of America	Bloomington	Bloomington, MN	\$68,108	\$65,599	4%	42%	35%	21%
14	Santa Monica Place / 3rd St	Santa Monica	Santa Monica	\$90,088	\$54,432	66%	71%	33%	115%
15	King of Prussia Mall	King of Prussia	King of Prussia, PA	\$82,126	\$56,907	44%	56%	31%	81%
16	Lenox Square	Atlanta	North Buckhead	\$99,185	\$53,843	84%	74%	50%	46%
17	Westfield Century City	Los Angeles	Century City	\$94,875	\$54,432	74%	57%	33%	74%
18	Westfield UTC	San Diego	La Jolla, CA	\$132,902	\$67,739	96%	65%	33%	95%
19	Westfield Topanga & The Village	Los Angeles	Canoga Park, CA	\$64,392	\$67,739	-5%	21%	33%	-37%
20	Flatiron	New York	Gramercy-Flatiron	\$113,705	\$58,856	93%	61%	37%	65%
21	Scottsdale Fashion Square	Scottsdale	Scottsdale, AZ	\$81,381	\$53,558	52%	59%	29%	103%
22	Oakbrook Center	Oak Brook	Oak Brook, IL	\$150,281	\$60,960	147%	63%	34%	86%
			Average	\$105,739	\$62,551	69%	59%	39%	51%
			Median	\$103,478	\$59,908	73%	61%	37%	64%

Retail Center Types

Notably, seven of the top ten retail districts predominantly consist of street retail. Westheimer Road in Houston, The Domain in Austin, and Cherry Creek Shopping Center in Denver are the three exceptions. The table below breaks out all digitally native retailers by location type. Street locations (42%) are ranked the highest. However, a majority of digitally native retailers are located in either indoor or outdoor shopping centers (58%).

Rank	Location Type	# of Stores	% of Total
1	Street	255	42%
2	Shopping Center - Indoor	224	37%
3	Shopping Center - Outdoor	129	21%
Total		608	100%

We also considered if the breakdown of street versus shopping center varied by retailer size. The following graph illustrates the breakdown of individual retailer location decisions. Each retailer is graphed with the percentage of street retail sites on the y-axis and percentage of shopping center sites on the x-axis. The retailer's size measured by number of stores is the bubble size. With the exception of three large retailers (Warby Parker, Indochino, and Bonobos), there is a trend towards larger retailers locating in shopping centers.



Chapter 5 – Discussion and Conclusions

Digital-native retail brands are opening stores at an accelerating pace. Of the companies studied, eight times as many brands opened retail stores in 2018 as 2011. Recent studies have suggested that digital-native retail brands will grow from roughly 600 to over 1,400 brick-and-mortar locations in the coming years. However, these projections only consider existing digital-native retail brands and their announced expansion plans. The lifecycle of a growing number of retail brands now begins online. Innovative digital-native brands, such as Warby Parker, have proven that brick-and-mortar stores can complement online sales. As a result, digital-native retailers will open a substantially higher number of brick-and-mortar locations as physical stores become the industry-standard growth strategy rather than a novel experiment. Real estate owners that develop leasing strategies focused on the specialized needs of digital-native retail brands are positioned to benefit.

The online-only retail model has clear advantages for start-up brands. The internet serves as a low-cost, low barrier-to-entry test environment with unlimited scalability should a brand gain popularity. E-commerce also has an enormous audience with nearly all Americans shopping online. Double-digit annual growth in e-commerce sales and faster, cheaper delivery methods should only make selling online more accessible and increase the number of start-up retail brands adopting a digital-native business model.

Given the momentum behind online retail, digital-native brands opening physical stores might seem counterintuitive. Technology companies are supposed to replace traditional retail. Netflix closes Blockbuster. However, Everlane CEO Michael Preysman explains, “being online-only has significant advantages. It’s flexible, it’s lean, and it’s easy to scale. But it has two serious flaws. Customers don’t get to touch or try the product before they buy it. And we don’t get to have in-person—real-life—conversations with our community” (Espinoza, 2017). Customers want to experience and engage with a brand, and the desire for experience translates into better financial performance for digital-native retailers. Brick-and-mortar stores significantly increase sales and reduce customer acquisition costs.

Pioneering digital-native retail brands, such as Everlane and Warby Parker, have proven a business model that starts online but thrives when online and offline sales channels work to

complement each other. The internet is a good brand incubator, but with 9 out of 10 retail dollars still spent offline in the United States, brick-and-mortar retail offers a path to significant growth.

New retail brands will increasingly follow the digital-native business strategy and establish themselves online before testing the physical retail market. Currently, the trend is somewhat of a novelty. 600 stores is a tiny fraction of the overall retail industry, but the precedent for digital-native brands growing through brick-and-mortar stores has been established. Consequently, an increasing number of digital-native retail brands will open physical locations. Landlords that understand the business strategy of digital-native retailers will be better positioned to attract them as tenants.

Based on the location data of 608 brick-and-mortar stores, we developed four insights into digital-native retailers for real estate owners and investors. This chapter discusses implications of each insight in detail and ends with a section on opportunities for further investigation.

The insights include:

- Digital-native brands concentrate in New York, Los Angeles, and San Francisco.
- Digital-native brands agglomerate in high-income areas.
- Consumers like to engage with high-touch digital-native brands at brick-and-mortar stores.
- Digital-native brands are attracted to premier shopping centers in addition to retail streets.

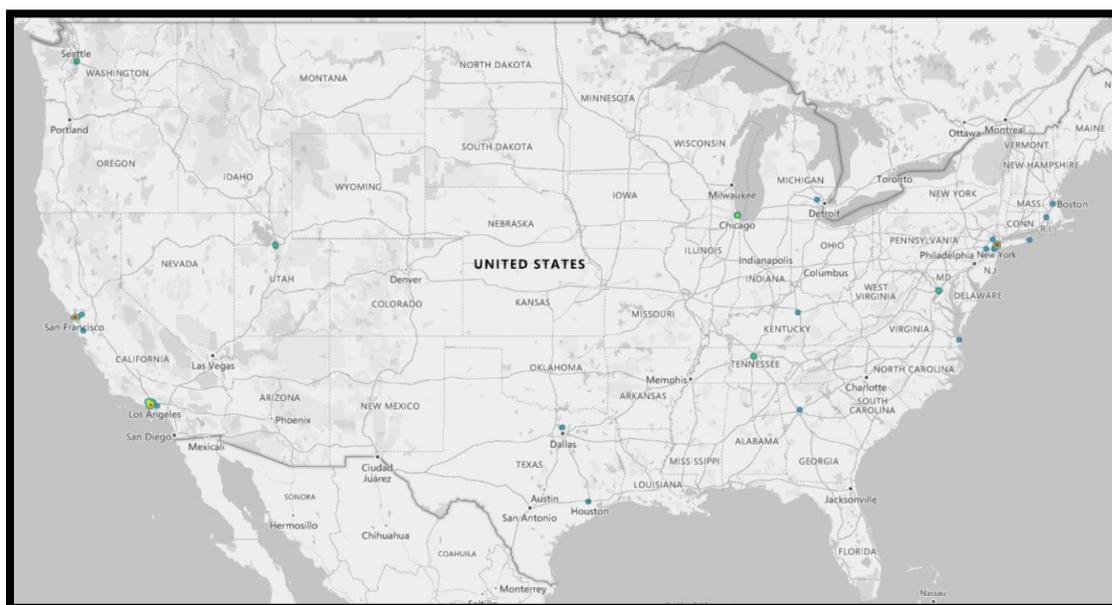
Digital-native brands concentrate in New York, Los Angeles, and San Francisco

This study confirms and expands on previous research by JLL on digital-native store locations. Cook and Einhorn (2016) found that after experimenting with pop-up stores, digital-native brands select a major city (usually New York) for their first permanent location. Stores are then opened in 2 – 10 major cities before expanding to smaller markets.

We analyzed the first permanent store locations for the 58 brands studied. 29 of 58 (50%) brands opened their first permanent location in New York City, and 17 of 58 brands studied (29%) opened their first permanent location in California (mostly LA or San Francisco). Within New York City, the first store for 15 of 29 (52%) brands is located in the SoHo neighborhood.

The preference for New York, Los Angeles, or San Francisco can be seen in the heat map of store location for brands with 5 locations or less. 55 of 79 stores (70%) are located in one of these three cities.

Heat map of brands with 5 locations or less:



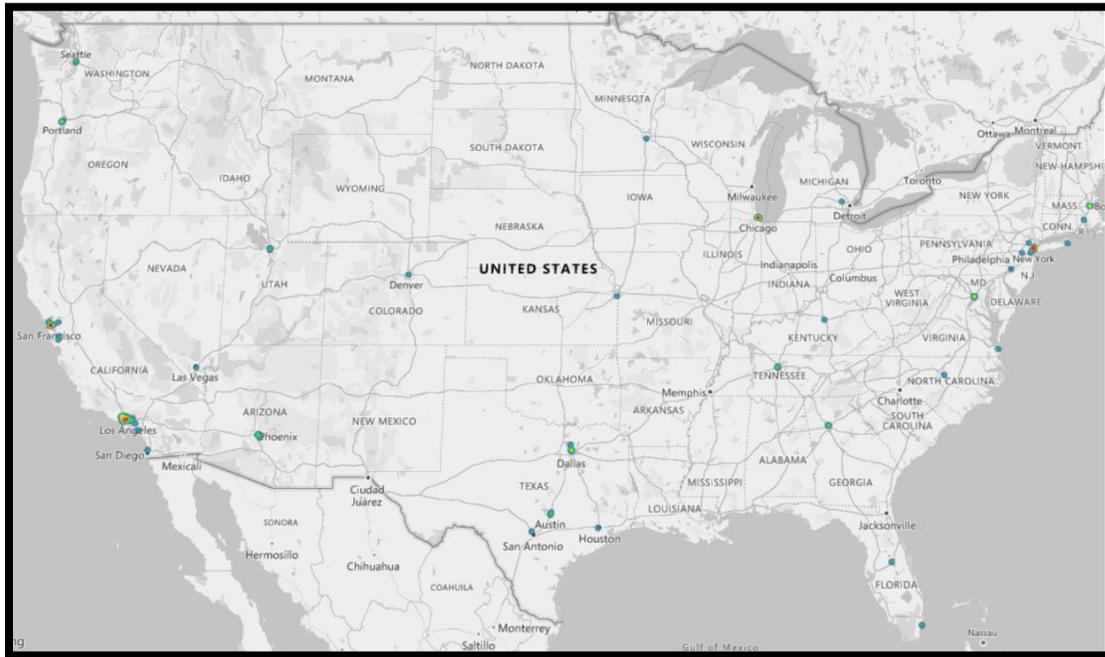
As brands expand, other major cities become target locations. The heat map below shows store locations for digital-native brands with 10 or less locations. For example, Chicago accounts for 16 of 192 (8%) of stores. However, New York, Los Angeles, and San Francisco remain the dominant destinations. Together, these three cities account for 107 of 192 locations (56%).

This location data suggests brands often prefer to open multiple locations within New York, Los Angeles, or San Francisco before expanding to other cities. For example, The RealReal has 10 total locations. 3 locations are in New York, 2 locations are in Los Angeles, and 1 location is in San Francisco. Adore Me has a total of 5 locations. 4 locations are in New York. Alo Yoga has 4 total locations. 3 are in New York and 1 is in Los Angeles.

Other digital-brands seem to spread out with only one store in major cities across the country. However, New York, Los Angeles, and San Francisco are typically included. For example, Away has 6 locations with one store in New York, Los Angeles, San Francisco, Chicago,

Boston, and Austin. Outdoor Voices has 9 locations with one store in New York, Los Angeles, San Francisco, Chicago, Boston, Austin, Dallas, Washington D.C., and Nashville.

Heat map of brands with 10 locations or less:



New York City, Los Angeles, and San Francisco may be digital-native brand’s preferred cities because they provide access to Millennial target consumers both in real life and online. In terms of overall population, New York City and Los Angeles are easily the two largest cities in the United States (US Census Bureau, 2016). According to the Brookings Institution (Varathan, 2018), California and New York rank number one and three in states with the highest Millennial population, 9.8 million and 4.8 million people respectively. In addition, California and New York rank in the top 10 states with the highest share of Millennials as a percentage of the population. Texas is the only other state to rank in the top 10 of both total Millennial population and highest share of Millennial population. However, number of consumers cannot be the only contributing factor.

Millennial consumers get a large portion of their brand information online. As a result, it is also important for brick-and-mortar stores to be “seen” online. Online traffic driven by a brick-and-mortar store can be just as critical as physical foot traffic. New York City and Los Angeles

arguably two of the best places to be seen online. In 2017, Instagram released a global list of the most-Instagrammed cities and most-Instagrammed locations of the year. New York City and Los Angeles were the only US cities in the top 10. New York City ranked first and Los Angeles ranked sixth. Five of the top ten most-Instagrammed locations were in New York or Los Angeles (Instagram, 2017).

The importance of New York and Los Angeles to branding can be extended beyond Instagram to American pop-culture more generally. According to Nielsen, New York and Los Angeles are the top media markets in the United States (Media Tracks, 2019). New York and Los Angeles also have large film and entertainment industries. According to IMDB data, the top 20 film locations in the United States are all either located in California or New York (Go Compare, 2019).

Retail property owners in New York, LA, and San Francisco have a unique opportunity to partner with digital-native brands looking to open stores in these three markets. Digital-native brands have mastered marketing online, but they often have limited experience in brick-and-mortar retailing. A first physical location is also a significant event in an online brand's growth. A brick-and-mortar store takes time and capital, but more importantly, the store openings often receive significant publicity. The media and customer attention is important in communicating a brand's carefully curated image. Performance of the first few stores may also be the proof-of-concept that enables a brand to raise capital for store openings across the country.

As a result, a digital-native retail brand's first brick-and-mortar location is a high-stakes bet that falls outside of the company's core competency. Property owners have an opportunity to leverage their expertise in physical retail to assist digital-native brands in successfully establishing their first few stores. Beyond leasing the physical space, landlords can offer help identifying store locations, completing tenant improvements, and assisting in the store permitting process.

Digital-native brands agglomerate in high-income areas

Demographics

Retailers locate their stores based on proximity to customers and to other stores. Therefore, we can back into the customer demographic digital-native brands are targeting by looking at the demographic characteristics of neighborhoods surrounding major retail districts.

A summary of the demographic characteristics of the top 10 digital-native retail districts is included below. These areas are high income with the median household income of the 10 districts greater than \$110,000 compared to the US median household income of \$59,039. They are also well-educated with 62% of adults having at least a bachelor's degree compared to the US average of 34%.

On average, the top 10 locations are 50% male and 50% female. The median age for males is 39 and females is 36. In 2019, the Millennials generation turns 23 to 38 which puts the median age at the upper end of the Millennial age group. A closer review of the age data reveals the largest generation by population in a majority of the top retail districts is likely in the Millennial generation. However, the average age is skewed upward by older residents.

Demographics of top-10 retail districts

Rank	Retail District	City	Neighborhood	Household Income	% Male	% Female	Male - Age	Female - Age	% Bachelor or Above
1	SoHo	New York	SoHo	\$ 124,396	50%	50%	38	35	70%
2	The Galleria	Houston	Uptown (Galleria)	\$ 138,918	48%	52%	45	44	60%
3	Melrose Avenue	Los Angeles	West Hollywood West	\$ 84,303	58%	42%	42	41	61%
4	West Armitage	Chicago	Lincoln Park	\$ 110,867	51%	49%	31	32	69%
5	Michigan Avenue	Chicago	Magnificent Mile	\$ 96,857	45%	55%	39	36	74%
6	Union Square	San Francisco	Union Square	\$ 56,401	59%	41%	39	32	44%
7	The Domain	Austin	North Burnet	\$ 58,498	51%	49%	35	36	32%
8	MStreet	Washington D.C.	Georgetown	\$ 128,591	47%	53%	33	32	64%
9	Cherry Creek	Denver	Cherry Creek	\$ 133,015	46%	54%	52	50	60%
10	Newbury Street	Boston	Back Bay	\$ 117,041	48%	52%	40	39	71%

The demographic study of top retail districts indicates that digital-native retailers target areas with very high incomes, very high education levels, and with a majority Millennial age demographic. Two major exceptions stand out. Union Square in San Francisco and The Domain in Austin have income and education levels very close to the US average. Union Square is a major shopping hub in the San Francisco Bay Area which is very wealthy overall. However, it is located directly adjacent to one of the least wealthy neighborhoods in the city, the Tenderloin.

Union Square is a shopping destination that wealthier residents and tourists are willing to travel to. The Domain in Austin is a similar story. The Domain is a premier lifestyle center but it is located directly adjacent to a highway and features an office park. High-income residents likely travel to the center for work or leisure rather than live in the surrounding neighborhood.

Agglomeration

Digital-native retailers also tend to locate near each other. The effect is particularly strong when fewer stores are located in a market. Warby Parker and Bonobos locations provide a good case study. There appears to be a strong relationship between their stores locations and store locations of other digital-native brands.

Warby Parker and Bonobos have 153 locations combined. The store location data indicates that both brands tend to locate near each other. Notably, 81 (53%) of 153 stores are located in a retail district that also has the other brand's store. In addition, Warby Parker and Bonobos are willing to try new locations together. 40 retail districts have both a Warby Parker and a Bonobos store. The companies are the only two digital-native brands located within 11 (28%) of the 40 retail districts. These data points indicate that Warby Parker and Bonobos likely have similar site selection criteria and may even target locations that include the other brand. Alternatively, landlords may be recruiting both brands as a pair.

Warby Parker and Bonobos store locations may also indicate location preferences for other digital-native brands. A majority of retail districts with two or more digital-native retailers have at least one of the brands. 70 (60%) of the 117 such retail districts studied have either a Warby Parker or a Bonobos store. These retail districts also tend to attract a large number of other digital-native retailers. Locations with either a Warby Parker or Bonobos store have a median of 4 other digital-native retailers.

Retail real estate investors can benefit from understanding how digital-native brands select store locations. These brands are basing store locations on customer data from their online stores. The sites selected indicate the brands believe there is strong target consumer demand in that location. The preference for agglomeration also means that a preferred street or shopping center in a new

market may be poised to benefit from other digital-native brands looking to move into the market. Real estate investors can benefit by being a leader in that area.

Consumers like to engage with high-touch digital-native brands at brick-and-mortar stores

Previous research has shown that digital-native brands selling “high-touch” or “experience goods” should be most likely to experiment with brick-and-mortar stores. Our findings were consistent with this conclusion. Of the 58 digital-native brands studied, 62% are selling apparel, 12% are selling accessories, 12% are selling home goods, 9% are selling cosmetics or beauty supplies, and 5% are in other categories. The concentration of brands in the apparel industry is also consistent with a recent consumer survey which found, “the ability to try items in-store is 3x more influential than other in-store purchase considerations” (Big Commerce, 2018). The data suggests clothing, accessory, and home good brands may be more likely to open brick-and-mortar stores because their customers want to try on or touch their merchandise before making a purchase.

A second theory is high-touch brands may place additional value on brick-and-mortar stores because physical stores facilitate meaningful interactions with their customers. Many apparel companies, for instance, try to develop their brand around a story, shared experience, or shared values. People communicate who they are through wardrobe choices, and a brick-and-mortar store may help to establish a shared identity between the customer and brand.

To investigate a potential connection between branding and brick-and-mortar stores, we looked at how digital-native companies market themselves. A consistent theme may indicate how opening a brick-and-mortar location impacts branding. The majority of digital-native brands studied do try to connect with customers on an emotional level. Of the 58 digital-native companies studied, 38 (64%) use a social or environmental mission to help brand themselves online. These results may show brands focused on shared values benefit from brick-and-mortar locations or digital-native retailers, more generally, brand themselves using shared value messaging.

One noteworthy concentration of digital-native brands with social missions opening brick-and-mortar stores occurs in women’s apparel. 100% of the women’s apparel companies studied brand

themselves using a social or environmental mission. Often the message is women's empowerment. For example, the brand Universal Standard markets itself as the source of fashionable styles for plus-size women. Their website states, "If 67% of women in the U.S. wear a size 14 or above, why were their options so dismal? It was clear that all women weren't given the same level of style, quality, or even respect" (Universal Standard, 2019). Although interesting, further research would be needed to determine if social-mission branding in women's apparel is unique to digital-native retailers or indicative of a larger trend in women's apparel overall.

The women's empowerment message could reflect broader cultural trends, including how women identify with clothing brands generally, or various other factors. Other factors may include the leadership and founding principles of the 13 specific companies studied. 12 of the 13 (92%) digital-native women's apparel brands studied were founded by women. The companies often highlight their founder as part of the brand's story. For example, M.M. LaFleur's website states, "Founder & CEO Sarah LaFleur was once your typical woman in finance whose closet was packed with blah-feeling pantsuits. Back then, she dreamed of a more practical, inspired wardrobe for herself and all professional women" (M.M.LaFleur, 2019).

M.M. LaFleur is using their founder's personal story to help convey an authentic brand message of shared personal experience in women's professional clothing. Additional research would be needed to determine if female founders are more likely to brand their companies with a woman's empowerment message or if the trend is unique to digital-native retailers. However, the "shared experience" component of branding does seem to correspond with brick-and-mortar retail stores.

In contrast to women's apparel retailers, 1 of the 7 digital-native men's apparel companies used a social-mission as part of their brand messaging. However, these retailers did still brand themselves using shared experiences. The men's apparel brand messaging tends to focus on creating an easier shopping experience or access to better fitting clothes. For example, Bonobos implies they understand men because they are men. Their website states, "Like most guys, we're not big fans of shopping ... We started Bonobos because we couldn't find pants that fit. They were either way too tight or too boxy. We fixed it." (Bonobos, 2019).

The “shared experience” brand message used by digital-native retailers seems to correspond with brick-and-mortar stores. A larger sample of digital-native brands would be needed to determine if this message is unique to brands with physical stores. However, the value of physical contact in developing a lasting brand-customer relationship is logical. Brands with high-touch products open brick-and-mortar stores to give customers more than just the opportunity to try clothes on. Companies use the physical interactions at brick-and-mortar stores to share their stories and develop a more authentic connection with the customer.

Digital-native brands are attracted to premier shopping centers in addition to retail streets

Digital-native retailers overall show a slight preference for shopping center versus street locations. We identified and coded 608 total stores as either street retail, indoor shopping center, or outdoor shopping center. 255 (42%) of the stores are located on streets, 224 (37%) are located in indoor shopping centers, and 129 (21%) are located in outdoor shopping centers. There is roughly a 60/40 split between shopping center and street locations. As shown in the analysis section, most individual retailers also trend towards shopping center locations as their total number of stores increases.

The competitiveness of shopping centers was a little surprising given the overall negative narrative on malls. However, it is important to note that many of the shopping centers are considered top-tier shopping locations in each metro area. As Dave Gilboa, co-founder and co-CEO of Warby Parker told the Associated Press, "we're not considering anything outside of the premier malls" (D’Innocenzio, 2018). Gilbo’s attitude towards shopping center locations appears to be consistent across many digital-native brands. Location preferences of digital-native retailers add to the argument that best-in-class malls located in strong markets will continue to perform well.

In a few cases, shopping centers can be compared directly with an adjacent retail street within the same retail district. In Santa Monica for example, Santa Monica Place, an outdoor shopping mall, is located directly adjacent to a prominent retail street (3rd Street Promenade). 5 out of 8 (63%) digital-native brands are located within the shopping center versus on the street. A similar result can be observed in Denver. Cherry Creek Shopping Center, an indoor shopping center, is

located directly adjacent to Filmore Street. Again, 5 out of 8 (63%) digital-native brands are located within the shopping center versus on the street.

Upon further investigation, digital-native brands are part of the leasing strategy for some shopping center owners. Sanata Monica Place owner, Macerich has launched a concept they call “BrandBox”. BrandBox provides turnkey retail space that can be leased short-term with a low upfront capital commitment. The target is smaller up-and-coming brands that might not have previous experience in brick-and-mortar retailing. “In Macerich’s traditional leasing agreement, brands typically lease an empty space and are responsible for getting their own brokers, lawyers, city permits and architects as well as installing their own fixtures, security cameras and traffic sensors, among other things, a process that could take three months to a year before the store finally opened” (Cheng, 2018). With the BrandBox model, Macerich delivers tenants a built-out store that can be ready for occupancy in three weeks. In addition, tenants can lease a BrandBox space short-term (6-12 months) compared to a standard retail leasing commitment of 3-10 years. This type of leasing arrangement shifts many of the store set-up risks from the tenant to the landlord.

Digital-native brands are showing that they find the low-risk space in shopping centers attractive relative to street retail locations. 13 of the top 20 (65%) retail districts identified in this study are shopping centers. In addition to low-risk space for start-up brands, the mall leasing model may be advantageous for brands growing quickly. Shopping center landlords typically have multiple, similar quality shopping centers located around the country. Their leasing strategy likely involves developing relationships with brands in the “BrandBox” type spaces. Then leasing traditional space to the successful brands across their shopping center portfolio.

The traditional advantages of shopping center locations seem to be translating to digital-native retailers. The low-capital, turnkey spaces combined with a streamlined leasing process is very attractive to a retail brand with limited brick-and-mortar experience. In a tenant-friendly leasing environment, retail landlords need to offer services beyond the physical retail space to attract digital-native brands.

Opportunities for further investigation

This study reviewed location data for 58 major online retailers that have opened 608 permanent physical store locations in the United States. Digital-native brands opening brick-and-mortar stores is a bright spot in the negative narrative on physical retail. However, additional research would help to solidify the arguments made in the conclusion section.

First, digital-native retail brands are a relatively small subsector of the retail real estate market. In the first six months of 2019, the United States saw a net closure of 4,040 retail stores (Coresight Research, 2019). According to Green Street Advisors, there are approximately 600 brick-and-mortar stores operated by digital-native retailers in the US (Mander, 2018). Real estate services firm JLL expects this number to increase by 850 stores over the next five years (Cook and Taylor, 2018). Even if these projections were doubled or tripled, digital-native brands still account for a small fraction of vacant retail space and the subsector cannot fill the amount of stores that are closing alone. Digital-native brands may like premier brick-and-mortar shopping center locations, but retail destinations are going to need to continue attracting a wide variety of tenants to stay viable and healthy.

Vibrant shopping centers and retail streets include everything from restaurants to grocery stores to gyms. Every day needs type retailers likely drive much of the customer traffic that digital-native brands benefit from. The digital-retailer location data could contribute to a broader study on retailers that are successful in today's marketplace. Retailers like coffee shops, boutique fitness studios, juice shops, and craft breweries are often associated with the same locations. Data on additional product categories would be informative to expand the research into other retailer types to see if conclusions remain the same.

Additionally, this study was limited to digital-native retailers that have opened permanent brick-and-mortar retail locations. Some of the trends identified may be applicable to all online brands, not just brands that have opened physical store locations. Many online-only brands are likely targeting the same Millennial customer group that prefers to shop online and wants to engage with a brand's story. Therefore, it seems likely that online-only companies may use similar marketing strategies. For example, many of the digital-native brands studied that sell women's apparel use a women's empowerment message. The same messaging may also be prevalent in

online-only Brands. Online-only women's apparel brand Beyond Yoga, for instance, advertises on their website, "female-founded and run, because empowered women empower women" (Beyond Yoga, 2019). A larger study of online retail brands would be needed to verify trends that are specific to brick-and-mortar retailers.

Lastly, this study focused on the characteristics of the retail districts digital-native retailers occupy. Additional studies could focus on predicting future or up-and-coming locations that have the potential to attract digital-native retailers. For example, population demographic characteristics such as income level appear to correspond with the retail districts that digital-native brands select for stores. Digital native retailers also agglomerate within submarkets. A predictive model could look at income, existing locations of digital-native brands, and other characteristics to identify up-and-coming retail destinations. In theory, the identified retail districts would also be the neighborhoods where digital-native retailer's target Millennial customers live and work. As a result, predictive tools based on digital-native store locations would be a practical method of identifying potential neighborhoods for real estate investment across product types.

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