The Growth of E-Commerce & the Retail Industry
Mixed Assumptions Pollute Retail Industry

“Retail apocalypse” is what many are referring to when discussing the closure of giant retailers who have historically been the main anchor stores in shopping malls and strip centers around the country. The rise of e-commerce, along with brick-and-mortar store closures and bankruptcies, have led to widespread fears about what lies ahead for the retail market. Melodramatic news headlines cloud consumer perceptions of the industry, and conclusions are quickly formed without assessing the market as a whole.

Shifts in Consumer Behavior and the Changing Retail Landscape

According to the National Retail Federation (NRF), perceptions of the industry’s death are overexaggerated. “Most consumers haven’t even heard of the companies that make up the list of 2016’s top 10 bankruptcies, but that’s not the case with retail. Retail is a part of our everyday lives in a way most industries aren’t; if a national brand closes stores or files for bankruptcy, we often feel a personal impact or connection to its demise,” writes Mark Mathews, NRF Vice President of Research Development and Industry Analysis.

In a recent article from Business Insider, they listed the top brand-name retailers that are closing the most stores this year. Store names and respective closures include:

- RadioShack – 1,430 stores
- Payless ShoeSource – 808 stores
- Rue21 – 400 stores
- The Limited – 250 stores
- hhgregg – 220 stores
- JCPenney – 138 stores

Consumer behavior could be deemed one culprit of the downfall and downsizing of some retailers. The millennial generation is the largest in U.S. history, and since they matured in a time of vast technological change, they utilize their devices more than any generation to date. Purchasing items at the touch of a button has become the norm, which has been fostering the growth and popularity of e-commerce over the past few years.

When it comes to top e-commerce retailers, Amazon dominates the list, with their 2016 total sales closing in near $140 billion. Their reported earnings have increased 122.6% over the past five years, and are showing no signs of decelerating any time soon. Amazon launched their “Prime” program back in 2005, offering subscribers two-day shipping for an annual membership fee. Over the years, they have rolled out more amenities to be included in the membership, including, but not limited to, video and music streaming, photo storage, and a virtual library to read on any Amazon or Kindle reading app. The innovations and investments made by Amazon to retain and grow their consumer base has helped the e-commerce giant over the years.

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1 Mathews, Mark, “Retail’s reinvention story is just getting started,” National Retail Federation, June 14, 2017
2 Peterson, Hayley, “More than 5,000 stores are shutting down—here's the full list,” Business Insider, June 4, 2017
Growth of E-Commerce

E-commerce allows consumers to make purchases without leaving their homes, at their convenience. Consequently, this results in less impulse purchases at adjacent stores when consumers shop at brick-and-mortar retail centers. Amazon is a platform that brings the product directly to the consumer, and in the modern-day lifestyle, convenience is one of the most highly desired elements when it comes to purchasing.

According to Federal Reserve Economic Data (FRED), over the past five years, e-commerce sales have been trending upwards and increasing by an average of $10 billion each year.

E-commerce and bricks-and-mortar stores are coexisting among the stronger retailers in the market. Amazon, Kohl’s, Target, Macy’s, Walmart, Costco, Gap Inc., and Apple are among the top 50 U.S. retailers by online sales, according to a study conducted by the NRF. During their 2017 Retail Advocates Summit, they expanded upon current market conditions to address the misconceptions on the alleged death of retail jobs. The statistics showed that the national unemployment rate in 2014 was 6.4% while retail sales workers totaled 8.64 million. In 2016, the numbers were 4.9% and 8.79 million, respectively.
The media’s fixation on the closures and downsizing of well-known retailers has portrayed the notion that the retail industry is in jeopardy. Many factors come into play when gauging economic conditions within a particular market, and while many stores are indeed closing across America, there are many triumphs within the industry that are overlooked. While news outlets are covering the weaknesses within the industry, highlighting the retailers that fail to adapt to our changing marketplace, the stronger retailers are leveraging technology to bring their services to the next level, giving themselves a competitive edge while simultaneously growing, both physically and in operational strength. The top 50 U.S. retailers by online sales, such as those previously listed, have found a way to embed e-commerce into their retail landscape, which was formerly dominated by their physical stores.

According to Tim Mehall, VP of Retail with Newmark Cressy Commercial Real Estate, enclosed malls of all types will always be here. Mehall states, “Traditional enclosed regional malls are not being built, but they will always remain part of the retail landscape. Their development has evolved in many cases into a more traditional, unenclosed city block format designed to be more pedestrian friendly and allowing shoppers the chance to park closer to their ultimate destination. This development direction typically includes less overall square footage.” With the continuously shrinking brick-and-mortar retail base, there will be a broader mix of uses within vacant space, as landlords begin to accommodate a broader range of tenants for newly developed space as well as for 2nd or 3rd generation spaces. Landlords are adapting to diverse ways to creatively market their space, bringing in tenants outside of the retail scope but still providing the accessibility and convenience of the location. The future of shopping malls is not doomed with the closure of anchor stores, but it will not be uncommon to see those vacant spaces be filled with food, entertainment, and/or fitness options, drawing in a wider range of consumers. Vacant space will constantly be absorbed—perhaps not by another retailer, but by another tenant who wants to add to the diversity of the surrounding area.

Market Shift – Mid-80s to Early 90s

Like the economy, the commercial real estate industry is a cyclical market. The demand for commercial real estate increased in the mid-1980s, after the U.S. exited a double-dip recession earlier that decade. Various retail categories became popular by demand, which resulted in many entrants to the market; however, the market shifted in the mid-80s and early 90s. After the initial boom had elapsed, successful stores in their categorical market increased in size to maintain a competitive edge while mediocre stores consolidated, downsized in commercial space, or dissolved entirely.

Indoor shopping malls were woven into the American culture by the early 1980s. The number of shopping mall developments spiked and reached its zenith by the 1990s, being built at a rate of 140 per year. The closure of big box and anchor stores that we are seeing in our modern day is a consequence of the peak that the U.S. experienced several decades ago. Too many malls opened simultaneously, and too many big box and anchor stores followed suit. This displays the paradigm of market equilibrium—since there was a surplus of similar retail centers, the closures that are happening across America is to rebalance supply and demand, thus attaining a period of equilibrium. The economics behind each market is cyclical in our everchanging world; therefore, we will continue to see supply fluctuate according to consumer preferences.

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Battle of the Fittest – A Repeat of History

When Amazon launched in 1995, it was a website that exclusively sold books. Borders and Barnes and Noble were one of the first big box stores to be impacted by the shift in consumer behavior. Borders placed a heavy investment into CD and DVD sales as the industry was gravitating towards digital media. Meanwhile, Barnes and Noble created more unique opportunities to expand their reputation from being a bookstore to becoming a destination for learning, entertainment, and personal development—from adding a kids’ play and learn area to hosting educational workshops. The fireplaces in addition to the Starbucks café create a comfortable nook to hold small meetings, read among their endless inventory of books, or study for an upcoming exam. Although Amazon posed a threat to their book sales, they shifted their focus to provide unique experiences that Amazon was not able to offer. They also joined the digital realm and developed their own e-reader, the Nook.

A more recent, parallel situation exists between Radio Shack and Best Buy, with big box stores competing against them, in addition to Amazon. Radio Shack moved into the cable, cellular phones, and satellite sales rather quickly; however, their electronic focus was far too narrow to stay afloat while its competitors were far ahead with regard to pricing and product range. Best Buy not only remained competitive by offering the latest in electronics and appliances, but they amped up the level of personalized customer service. Best Buy strived to add “store-within-a-store” concepts from major partners such as Apple, Microsoft, and Sony. Additionally, in 2002, Best Buy acquired Geek Squad, offering customers in-store, online via remote access, and 24-hour emergency support. They also improved upon their website by offering more items that may not be found in-store.

Fast forward to 2017, now we are seeing a similar repeat of history, but this time it is to the big box stores in the retail industry, not just bookstores. The Borders of the retail industry who fail to adapt to the changing consumer behavior will be the primary victims of e-commerce. With many competitors to choose from, consumers will gravitate to the ones who give them the most unique experiences, giving them the most value for their dollar.

Local Market Conditions

Store closures in the South Bend/Mishawaka region are not as severe as various other regions across the US. While JCPenney, Sears, Rue 21, Macy’s, and Payless are among the many retailers shuttering hundreds of stores nationwide, many of their stores are standing strong in our local market. One exception is Kmart, a wholly owned subsidiary of Sears Holding Company, which is closing its doors in Mishawaka. Additionally, Rue 21 in South Bend’s Erskine Village has also shuttered. However, both Sears and Rue 21 locations in University Park Mall have remained open, indicating nothing other than this is not a multi-store market.

Many question the impact on the rent of same-market properties. The good news is that overall occupancy rate within the retail market in the Midwest remains high. As a result, the rent is stable and is not seeing drastic fluctuations. Rent and market status/activity are positively correlated; therefore, if demand for same-market is high, rent will also rise to meet the demand. Conversely, if market activity is low, then rent would be stable and low as well.
Mehall says that our local retail market reacts more to demand than anticipated demand. Therefore, when the overall economy goes through a period of decline, it may not be initially obvious, but our local retail market does not get hit nearly as hard as other markets. Conversely, the larger metropolitan markets tend to develop residential and retail property simultaneously in anticipation for a high demand. As a result, these markets are impacted more severely when the economic condition regresses.

The strength displayed in our local market is unique in its ability to withstand economic downturns better than larger markets. The pace of development seen within the South Bend/Mishawaka area tends to lag behind primary markets, which empowers business leaders to make more accurate forecasts in their relative markets based on national trends.

Where is the Market Trending?

As noted, e-commerce may be causing a drop in the number of retail stores, but there will be a rise in warehouse and distribution centers. Online vendors must strategically place their distribution centers in the middle of the country, which proves to be a solid boost for the present and future of the Midwest commercial real estate market. The retail world is being transformed by this new mobile revolution. We are entering an era of instant-gratification, where consumers want their purchases, and they want it now. As a result, many retailers are promising quicker deliveries, enabling consumers to indulge in the direct-to-home amenity.

Another shift within the retail sector has occurred as a result of how Americans are choosing to spend their discretionary income. Consumer spending has shifted from purchasing tangible items to purchasing experiences. Data shows that restaurant expenditures have exceeded what they have been in previous years, as more spending is allocated to this category and less is spent on apparel and accessories. The graph below shows consumer spending trends in three categories over the past two decades.

In just five years, restaurant spending has increased by 29%, whereas spending on apparel and accessories has increased 11%. It could be argued that e-commerce has played a role on the decline of gasoline spending, down 19%, because less commutes are being made to retail centers.
Retail Recap

“Retail apocalypse” may be an overdramatization of the current market conditions. Store closures and resulting vacancies does not signify a growing sector; however, it would be a cause for greater concern if most of those vacancies were remaining stagnant over an extended period of time. What we are seeing is a reinvention of the retail industry, as well as a shift in tenant types within structures that were historically retail-specific. As technology advances, consumer behavior will change with it. The only way to stay competitive is to adapt to those changes and continue innovating. Big box stores are seeing the biggest dent in lost market share to Amazon; the market is forcing them to close stores, get creative, and/or differentiate themselves from competitors. The successful retailers are those who leverage technology to enhance the customer experience when they come into the stores, in terms of both brand and service.

Amazon may be a leader in the e-commerce arena, but many retailers have added uniqueness to their brand that others cannot offer, and therefore remain competitive in the market. Those who adapt will survive—those who don’t will downsize or dissolve. Like all other markets, it is a battle of the fittest.

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