FULL REPORT

Future Shock or E-Hype?:
The Impact of Online Shopping on
UK Retail Property

Report Prepared by
THE COLLEGE OF ESTATE MANAGEMENT
Patron: HRH The Prince of Wales
A trend is a trend is a trend. But the question is, will it bend? Will it alter its course through some unforeseen force and come to a premature end?"

Sir Alec Cairncross, 1971

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We should stress that any views expressed in this independent research are the researchers’ own and may not necessarily represent the views of BCSC, RICS, or of the steering group members and their organisations.

A glossary is included for readers at the end of the report

RESEARCH TEAM:

Dr Tim Dixon, Director of Research
Andrew Marston, Research Assistant
Gaye Pottinger, Research Officer

College of Estate Management, Whiteknights, Reading, RG6 6AW
Tel: 0118 986 1101 Fax: 01189 975 5344
Website: www.cem.ac.uk
FOREWORD

The recent shakeout of dot.coms has perhaps lent some credence to the view that UK retailers and the shopping centre industry can relax as far as e-commerce is concerned. Shoppers will surely continue to shop in physical stores and etailers have their work cut out just to stay afloat. As this research report shows, the high street is certainly not dead, but it also highlights the fact that we should not be complacent about the impact that ecommerce will have on us all over the next 5 years.

The College’s research addresses both the ‘armageddonist’ and ‘ostrich’ arguments, and provides a balanced and rational view of the world and how it might shape up in 2005. It holds valuable lessons for us all, not least the fact that it will be vital to monitor our progress closely over the next 5 years. Technology can change fast, but at the moment we have sufficient time to ‘Internet-proof’ our shopping centres through active and rational management.

The challenge will be to combine the best of the ‘bricks’ and ‘clicks’ worlds and to provide an environment that brings shoppers back for more. In turn, this will maintain investment performance in the light of many heightened pressures for retailers, and not just from ecommerce.

There will certainly be winners and losers, and ecommerce is likely to impact on both retail sales and rental values. Our industry faces major challenges in making sure we integrate this new medium within a multichannel environment to protect and enhance our assets. As Yogi Berra, the US baseball star, once said, ‘Forecasting is very difficult, especially if it’s about the future’. This comprehensive and timely research helps provide us with a set of valuable roadmaps to plan for that future.

Francis Ives
President, BCSC
February 2001
# BCSC

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EXECUTIVE SUMMARY

This research examines the impact of ecommerce on sales and rental values and on the future space and ownership/leasing requirements of UK retailers for 2000-2005. The independent study, commissioned by BCSC (and funded by BCSC Educational Trust with support from the RICS Education Trust), included a major postal survey, follow-up interviews, a retail focus group, and shopper survey and case study of Cyberton, a town in the South East of England. The research was conducted by the Research Department of The College of Estate Management, Reading, between June and December 2000.

Main Findings

- Ecommerce must be considered alongside other vital issues affecting retailing today such as the changing work and leisure patterns of consumers, demographic changes, deflation and lower margins.

- The Internet will impact on UK retail property within 5 years and will lead to lower rental growth, higher yields and lower capital values and returns, but it will not mean the death of the high street.

- Rental growth could slow by between 0.2% pa and 0.5% pa over the period 2000-2005. This is an ‘average’ figure and there will be differential impacts within towns and between towns. It also depends on a number of factors including the online share of total sales, ratio of store to home/catalogue diversions, and overall cannibalisation rate.

- Properties occupied by banks and travel agents are seen as most at risk by all respondents in our survey over the next 5 years. The music, video, software and books sectors will also see a greater impact than other sectors.

- Prime, standard shops, large city shopping centres and out-of-town regional shopping centres are least at risk.

- Comparison shopping is most at risk and large cities will be relatively more immune to ecommerce impacts on trade than smaller rural towns.

- There will be increasing polarisation of prime and secondary property within centres. Developing a ‘shoppertainment’ theme will help to bolster successful centres.

- Retailers are surprisingly bullish about their future property needs over the next 3 years. Some 65% of retailers in the survey wanted to increase their retail space. This is in contrast to recent published evidence of retailers’ short term space requirements.

- Retailers do not believe the Internet will reduce the need for retail space. Etailers also need property and there is evidence of ‘reverse convergence’ as etailers move into physical space and ‘bricks and mortar’ retailers acquire an online presence.

- ‘Bricks and clicks’ retailers with a strong brand have a bright future. Many dot.coms have a much less certain one.

- Although leasehold space dominates UK retailers’ portfolios, freehold dominates in value terms.

- Accounting changes, to be brought about by proposals to amend SSAP21, may lead to shorter leases. Retailers want more flexible and shorter leases, and more than one-third
of larger retailers are considering some form of property refinancing and restructuring over the next 5 years.

- Customer fulfilment and security issues are the most important barriers to the growth of ecommerce in retailing. Logistics and delivery issues are equally critical. The ‘digital divide’ in the UK, nationally and between towns and regions, is a major issue.
- Future developments in ecommerce will mean multichannel retailing underpinned by strong brands. Wired leases and B2B efficiencies in retail markets may also impact later on.

Main Findings
Can we debunk any myths?
We believe the findings of our research can debunk some ‘myths’ fairly robustly.

‘Ecommerce will mean the death of the high street.’
False. Although parts of the high street are under threat (particularly financial services and travel), those stores that integrate ecommerce and have a strong brand will continue to be successful over the next 5 years. What is difficult in any research of this kind is to tease out the impact ecommerce will have alongside all the other concerns there are over retailing, including price deflation, falling margins and rents outstripping sales. Certainly there will still be concerns for retailers operating on low margins, despite the future impact B2B may have on their costs. Technology changes rapidly, however, and so it will be vital to monitor and benchmark progress as we move towards a future where fast Internet access will widen in scope.

‘Retail property values will be hit…’
Only partly true. There is mounting evidence to suggest that this is already happening, and not just because of ecommerce. Retail yields have generally moved out during 2000 because of more pessimistic investor sentiment over such factors as the weak retail market and oversupply of accommodation. But ecommerce is likely to increase the polarisation between prime and secondary property and between towns. If ecommerce slows rental growth by up to 0.5% pa over the next 5 years then we will also see yields moving further to accommodate this fall, if they have not done so already. As another risk factor, ecommerce will have a differential impact on particular kinds of property as we have seen in the research. Clearly, if economic growth slows, then that would also hit spending, sales and ultimately rents, but then all forms of shopping would suffer, not only store-based shopping.

‘The future lies with dot.coms…’
False. This seems unlikely to be true. The future seems to be very much multichannel with ‘bricks and clicks’ dominating (i.e. a physical presence combined with an online sales channel). For example, Webmergers.com suggest that 210 US Internet companies folded in 2000, with 75% in the B2C sector. There have also been a litany of failures in the UK sector. With high cash burn rates and falling stock value, dot.coms are no longer the rising stars they once were with analysts. Finally, in February 2001, Amazon.com, the world’s largest online retailer, announced plans to cut 1300 staff or 15% of its workforce, but also forecast that its sales would be 10% lower than expected in the coming year.

‘Retail property will be deadweight…’
False. Even etailers need property to operate. Retailers want more flexible leases and are looking in some instances to move property off their balance sheets because of accounting
changes and other drivers. ‘Reverse convergence’ may become more common as retailers move into physical property and e-tailers move into virtual space.

**How and when will ecommerce impact on retail in the UK?**

Our survey suggested retailers were more sanguine than developers/investors and their advisers about the impact that ecommerce would have on rental and capital values, yields and returns over the next 5 years.

Overall, respondents thought rental values, yields, capital values and returns were mainly at low to medium risk. Retailers were more likely than the property industry to consider these factors to be at no risk, and a greater number of retailers also considered all factors except rentals to be at high risk. This suggests a greater polarisation of views in the retailer group.

Returns, capital and rental values are expected to fall and yields rise, although a greater proportion of property industry respondents believed this, perhaps reflecting their greater knowledge of property factors.

A majority of respondents in our survey felt that ecommerce would impact on UK retail property within 2-5 years. Retailers, investors and developers see the impact as taking a little longer than investment advisers.

Banks and travel agents were seen as being most at risk whereas prime standard shops, large city centre shopping centres and out-of-town regional centres were less at risk. This suggests an overall risk spectrum, as shown in Figure 1.

We also found that comparison shopping is perceived to be especially at risk in secondary locations. Investors and developers see niche retailing as the least risky of all sectors, with convenience retailing being viewed by all respondents as being less at risk than comparison shopping. Figure 1 summarises the key trends.

**What will be the likely impact on retail sales and rents in the UK?**

By 2005 our scenario models suggest that the online share may be of the order of 2.5% to 5% of total retail sales (including home shopping but excluding financial services and travel). An online share of 7.5% by 2005 seems less compelling at this stage because it would require 73% pa growth to 2005 and rapid roll out of Internet access and broadband over the same period. This view is also supported by evidence from our retail focus group and research by ICSC in the USA.

Our scenarios also show the impact of 50% diversion from stores and 100% diversion from stores. It seems more likely that at least some diversion of sales will come from home catalogue shopping, making a 50% diversion more likely. We also assume an overall ‘cannibalisation rate’ of 93.5% pa for online sales (based on our own focus group findings and other published data, including figures from Verdict).
If this is the case, then rental growth may be reduced by 0.2% pa or just under 0.5% pa over the period 2000-2005 in each of the two scenarios (‘sluggish’ and ‘growing’ respectively).

However, these are average figures only and our Cyberton and shopping centre case study showed the need to examine floorspace balance carefully within towns. In our shopping centre study, the potential reduction in rental growth was negligible (about 0.1% pa) in the ‘growing’ scenario (on the assumption of a 50% sales diversion from stores). Shopping centre owners will also face a major challenge in determining the right balance between a tenant mix that optimises shopping centre footfall (e.g. a large chemist store), captures spending growth (e.g. household goods) and minimises exposure to sectors most prone to online diversion (e.g. books).

It is also clear from our analysis that there is a very real and continued threat to financial services and travel. In Cyberton some 16.5% of space is in threatened categories, which includes those services.

Therefore retailers cannot afford to be complacent. Our desktop analysis of retailers’ accounts showed that with low margins a number are under threat even if turnover levels fell by less than 5% pa. This may well prove to be the case in some sectors even in the ‘sluggish’ and ‘growing’ scenarios.

How are UK retailers’ property requirements changing as ecommerce evolves?

The impact of ecommerce and its impact on retail property must be judged against the backdrop of some burning issues in retail property such as:

- The future for corporate retail property in the light of changing accounting standards and the moves to off balance sheet vehicles.
- Changing floorspace patterns as competition between in-town and out-of-town centres continues and planning policies bite.
- A slowdown in retail property investment performance.
- Falling lease lengths, reducing sales growth and higher rents.

Our postal survey sample was dominated by high street retailers. Retailers generally held more leasehold space than freehold space. The average portfolio, for example, comprised 61% leasehold and 34% freehold space. In value terms, however, our analysis suggests the position is reversed. For example, in 1999 the mean percentage of freehold property (by value owned) in our sample of top retailers was 65.4%. The same analysis also shows a drift to leasehold by value over time, however, as the figure for freehold by value was 68.7% in 1994.

The high levels of property ownership (by value) amongst retailers reflects the need for sale, storage and distribution, but also the high value of retail property. Indeed, property assets are often used by retailers as collateral for corporate debt in order to finance trading growth. However, as the proposed accounting changes bite, we may see a more substantial drift towards and shorter leases.

Our survey certainly suggests that retailers would prefer to have shorter leases than they do already. Generally, leases are currently more than 10 years in length (particularly so in the large retailers group (77%), with nearly 40% of retailers having average leases of 11-15 years). These figures are in line with earlier work by the University of Reading. More than 70% of
EXECUTIVE SUMMARY

larger retailers wanted shorter leases of 10 years or less, which we believe is due to the general increased demand for flexibility, underpinned by the forces outlined above.

We also found a drive towards possible refinancing and restructuring of property by larger companies (more than a third of the larger retailers were considering this, particularly through sale and leaseback), driven by:

- Need for flexibility
- Property market dynamics
- Availability of resources
- Ability to win business.
- A view that came quite strongly from this was that the Internet was not reducing the demand for space.

The increased demand for flexibility has also resulted in the take up of turnover leases. Turnover leases are still not widespread in the UK, however. For example, for 70% of retailers who had turnover leases, they still only make up 10% or less of their portfolios. Similarly two thirds of investors using turnover leases only have 10% or less of their retail portfolio let on them. Despite this, a number of interviewees felt that turnover leases could become more common in the future.

Horror stories of deflation, falling margins and store closures do not seem to have adversely affected the bullish views of retailers. Our survey showed that 65% of retailers saw a need to increase their retail space over the next 3 years, and larger retailers were also looking to expand their distribution space. There seemed to be a tendency for predominantly leasehold space occupiers to be bullish about expansion in retail, perhaps reflecting greater optimism of their flexibility and response to changing demand than other more property heavy retailers.

Those retailers who were reducing their space requirements were doing so for a variety of reasons. The importance of B2B, for example, was mentioned by one but the message is that ecommerce is not yet reducing the perceived need for retail space. This mirrors the findings from our restructuring/refinancing question referred to above.

Generally retailers expected their occupation costs to increase over the short and medium terms, and those who thought costs would stay the same in the short term felt they would increase over the medium term. Those who saw their costs decreasing were generally those who felt their space requirements would also decrease.

**How will ecommerce develop in UK retailing in the future?**

Despite the importance of key barriers such as security and customer fulfilment (such as delivery and supply logistics) ecommerce will continue to impact in the UK over the next 5 years. The research also showed evidence that the digital divide can exist in towns where the overall degree of Internet access is high. Widening participation rates is a declared aim of the current government and we will see an increasing number of public Internet kiosks as local authorities and town centre managers work with retailers to improve shopping environments.

As to the future there were fairly strongly held views that:

- To be successful, physical retailers had to find effective ways of combining shopping, leisure and entertainment.
Polarisation between prime and secondary property was also likely to have an increasing impact.

B2B and wired leases had some way to go before they impacted.

Digital TV and mobile commerce would be part of a multichannel future. These would be supplemented by kiosks and interactive services in shopping centres becoming more popular.

This also suggests the most successful shopping centres will be the ones that are well located with good access and have the characteristics shown in Table 1.

There will be an increase in the number of shopping centre websites in the UK and they will develop from a purely informational basis to one which enables links to individual stores for shoppers to buy online. This raises the issue of wired leases. The issues of returns and sales on the website away from the store, both of which can affect turnover will need to be resolved.

On the issue of flexible leasing structures there is a trade-off here. If leases do become shorter, and if e-commerce continues to bite, we may see more aggressive management from owners in the UK to weed out under-performing retailers, just as is happening in some instances in the USA.

In the USA the e-commerce landscape differs, and it is also true to say that the US shopping experience and retail industry is very different from our own. This has also been reflected in the relatively rapid growth of web access to shopping centres in the USA (88% of shopping centres currently have websites compared with 10.5% in the UK), a country where the geographical scale of things is much greater. Nonetheless, valuable lessons can be learned from the US experience of companies such as Simon Property and General Growth.

In the UK ‘bricks and clicks’ retailers would seem to have the edge on pure-play etailers. The stock of dot.coms has fallen dramatically over the last year, and the future of many is still uncertain. Perhaps the advantages of etailers being lightweight in property have been overplayed. Our limited survey of dot.coms suggested that property was still needed even by etailers. There was also some limited evidence of ‘reverse convergence’, as etailers seek to expand their physical space.

What are the policy implications?
The research also highlighted a number of potential policy implications:

Town centre management. Close relationships between developers, retailers, the local authority and town centre managers are important to maintain. Synergy through the development of Internet kiosks to widen access in towns is an important outcome of such close working partnerships.

A3 uses. If financial services continue to contract, the possible conversion to A3 uses may reach its limits. Physical banking is still needed and the implication of continued decline of demand for space in such uses will require closer examination, particularly at a local level.
Regeneration. If ecommerce changes the shape of cities and urban form through polarisation, this has important implications for urban regeneration as some areas of a town decline and others grow. The same is true at a regional level with Internet access rates varying and with different types of centres set to win and others lose as ecommerce begins to impact.

About the research
The research was conducted during June to December 2000 and comprised:

- *Literature review and background study* summarising key themes and trends and highlighting previous important research. A detailed analysis of a sample of major retailers’ accounts and balance sheets was also undertaken and US case studies included, based on visits and interviews undertaken in the USA.

- *A postal questionnaire survey of retailers, investor/developers, and their advisers.* A total of 263 usable questionnaires were returned, representing a response rate of 12%. Of these 156 were from retailers (11% response), 77 from investors and developers (15% response) and 33 from surveyors (15% response). In addition six questionnaires were returned from pure-play Internet retailers. The sample included 5 of the top 10, 13 of the top 50 and 16 of the top 100 retailers.

- *Face to face and telephone interviews* were conducted with senior people in ecommerce, property and finance departments from:
  - 5 physical retailers with varying levels of exposure to the Internet. All were major high-street names and all appear in the top 100 list of retailers according to Retail Intelligence’s Retail Rankings for 2000 and three appear in the top 10. One pure-play retailer (founder and Director) was interviewed.
  - 4 investors/developers (senior directors and/or researchers interviewed).

- *Cyberton case study* based around shopper surveys in a town in south east England with a high degree of Internet access. More than 450 shoppers were interviewed and a retail focus group with 17 attendees from 10 local retailers (multiples and independents), 2 shopping centres, and representatives from business groups and the local authority. This was supported with an analysis of how ecommerce may impact on a major shopping centre in the town. The town is named Cyberton for reasons of confidentiality.

- *Scenario studies*, comprising ‘Sluggish’, ‘Growing’, and ‘Rapid’ and underpinned with a quantitative framework. The scenarios are not intended to be forecasts but are designed to indicate the possible impact of ecommerce on sales and rents over the period 2000-2005, depending on the assumptions within the scenario adopted. National scenarios were prepared, and the same scenarios carried over to a local level to our case study, Cyberton.

The College intends to continue this research as an annual benchmarking study to inform and provide benefit to the retail, shopping centre and property sectors.
1 INTRODUCTION

1.1 Background and context to the research

Over the last few years the term ‘ecommerce’ has grabbed the headlines in the UK and throughout the world, and has been the subject of much intense debate. In the world of retail property, which is facing severe pressures and changes of its own, opinions vary widely on the potential impact of ecommerce. Here are just some of the claims that have been made:

- ‘The Internet will extend the electronic marketplace and become the ultimate go-between, the universal middleman’. Bill Gates
- ‘Ecommerce does not merely master distance, it eliminates it’. Peter Drucker
- ‘Someday I believe cybershopping will have an added attraction: it will be fun…in cyberspace no-one can hear you shop’. Paco Underhill
- ‘Online retailing won’t replace instore retailing. I’ve never said that. But I do think it can be a different, enriching experience. I think shopping on the Internet can be a more social experience in many ways.’ Jeff Bezos, Amazon
- ‘You’d better sell your shopping centres. In 2010, half of the retail stores in America will be closed because half of all purchasing will occur online. The whole notion of an automobile-based retail infrastructure is dead’. Lester Thurow
- ‘We’ve always said the Internet is a future not the future. It’s not for everyone. There are always going to be people who want to come into stores’. Russell Craig, Tesco
- ‘If the Internet phenomena is able to register growth trends comparable to the Sears Home Catalog then it would clearly deserve all the press and attention the Internet retailers have been receiving.’ Merrill Lynch (1999).

Forecasting the future of a new technology is fraught with difficulty, particularly when examples abound of technologies that were supposed to change the world but never did. For example, the ‘Victorian Internet’ (the wired telegraph) was heralded in its time as the harbinger of world peace. The same claims have also been made about the modern-day Internet. Despite the hype, however, ecommerce is here to stay and cannot be ‘uninvented’.

Already the battle lines are being drawn up as to the impact ecommerce and the Internet will have on retailing. On one side are the ‘armageddonists’, those who see an imminent meltdown in the high street as the Internet takes hold; on the other side are those who argue the Internet has no real future in shopping and the physical experience will continue to hold sway.

Perhaps the truth does lie somewhere in the middle but seeking the truth in such a complex area is not easy. Figures and forecasts abound and there are a plethora of reports which claim to provide the definitive view. Part of our role in producing this report has been to try and unravel the many conflicting views and thoughts that abound, and to highlight what we consider are the most important findings from previous research to provide context to our own research.

Our task is to provide a clear and concise overview of the key problems and issues, by taking a considered and holistic view from the retailer, investor/developer and shopper perspectives.
Each in their own way are key players on the retail stage, and our intention has been to provide a balanced and rational perspective on how the future direction of e-commerce and the Internet may impact on UK retail property.

1.2 Aim and Objectives

More formally the research aims to provide a comprehensive study of the impact of e-commerce on the future space and ownership/leasing requirements of UK retailers over the period 2000-05. The research is intended to provide:

- an up-to-date survey of how e-commerce is impacting on retail property, a key sector of the economy;
- a better understanding of how e-commerce is shaping owners’ and occupiers’ future property needs and requirements;
- a clearer view of those retailers which are most likely to be affected and how strategic real estate decisions are being made to manage the resultant changes;
- an analysis of the drivers and barriers shaping the impact of e-commerce on retail real estate.

The research therefore addresses specific questions which are anchored around three main areas of interest. They comprise:

Retailers’ and Investors'/Developers’ Perspective

- How is e-commerce developing in UK retail?
- What are the barriers and drivers to e-commerce?
- How important is e-commerce for retailers alongside other issues such as changes in accounting standards and shorter, more flexible leases?
- How are UK retailers’ property requirements changing as e-commerce evolves?
- Are etailers’ property requirements different from conventional retailers’?
- How and when will e-commerce impact on retail in the UK?
- What is the likely future path of e-commerce in UK retail?
- What lessons, if any, can be learned from the USA?

Shoppers’ Perspective

- What do shoppers think about e-commerce?
- Is there a digital divide?
- What products and services are under threat from the Internet?

Forecasting the Future of E-commerce – The Potential Impact on Sales and Rents

- How can we forecast the future size and impact of e-commerce?
- What are the problems and issues associated with such forecasts?
- What is the impact on sales and rents nationally and at town and shopping centre level?
1.3 How was the research carried out?
The following research methods were adopted:

- Postal questionnaire survey to UK retailers, investors/developers and their advisers;
- Structured face-to-face interviews with leading experts in the field;
- Case study of ‘Cyberton’ (a large town in the South East of England) using a shopper survey, a retail focus group and live shopping centre data.

This was underpinned with three scenarios, which were used to highlight the potential impact of loss of trade from conventional channels to ecommerce on rents.

The three scenarios are shown in Table 1.1 and comprise ‘Sluggish’, ‘Growing’, and ‘Rapid’. All three scenarios are based on the assumption of 0.6% online sales share in 2000 (or £1.24bn) as a percentage of all retail sales.

The scenarios offer differing views of how ecommerce may impact on UK retail over the next 5 years. In particular, they are designed to show:

- How ecommerce might divert potential offline sales to the online channel;
- How this effect may vary across different types of good; and,
- How the potential lost store-based sales may impact on rental growth prospects nationally and locally.

The scenarios are not intended to be forecasts but are designed to indicate the possible impact of ecommerce over the period 2000-2005, depending on the assumptions within the scenario adopted.

National scenarios were prepared, and the same scenarios carried over to a local level in our case study, Cyberton, a town with a high degree of Internet access.

1.4 Format of Report
Background and Literature Review (Sections 2 – 4)
Whatever one’s viewpoint there is a very real need to understand how we have arrived at where we are today and what forces will shape the future of ecommerce, the Internet, and hence retailing in the UK. To assist in this, the first part of this report comprises a literature and research review, which is divided into three parts:

- The growth of ecommerce and its impact in retailing
- The changing landscape of ecommerce and retailing and
- Ecommerce and retail property

These three sections are therefore intended to provide a context and backdrop for the research, which is the main focus of the report.
**Research Questions and Methods (Section 5)**

This section outlines the processes and methodologies used throughout the course of the research and includes details about the postal questionnaires, shopping survey, structured interviews and the Cyberton case study.

**Results (Section 6 – 8)**

Our results section is divided into three separate sections designed to address different aspects of the project. All sections combine elements from the different methodologies employed to provide a combined, but detailed commentary. The three main results sections focus on:

- The retailers’ and investors'/developers' perspective – this section examines how UK retailers are using the Internet, the importance that they place on the Internet, how their property strategies are evolving and which types of real estate are most under threat.

- The shoppers’ perspective – this section draws heavily on the views from survey of consumers.

- The potential impact of ecommerce on sales and rent – concluding the results, this section presents forecasts and models for the national and local growth of Internet shopping and examines how such changes could affect sales and rental growth from 2000-2005

**Conclusions and Summary (Section 7)**

This section includes the overall conclusions of the research, as well as a summary of the main findings.
Key Points

What is ecommerce?
- Ecommerce can be defined as: ‘the exchange of information across electronic networks, at any stage in the supply chain, whether within an organisation, between businesses, between businesses and consumers, or between the public and private sectors’ (Cabinet Office, 1999).
- The Internet is a ‘disruptive technology’, coming in a long line of innovations in the retail sector. What distinguishes it from previous technologies is its scope and rapid global growth.

Forces of change in retailing
- The growth of ecommerce in the UK must be seen against the backdrop of other powerful forces in retailing. These include: changing work and leisure trends, demographic changes, increasing consolidation in retailing, falling real sales densities, deflation and lower margins and increasing globalisation.

The growth of the Internet and ecommerce in the UK
- Ecommerce is being driven by rapid growth in Internet access. Some 32% of UK households now have online access. Despite this, there is evidence of a ‘digital divide’ both within society, and geographically, in the UK.
- The UK compares favourably with the rest of Europe in its take-up of new technologies. In particular, the country has a strong base of cellular phone users and digital television subscribers. It is dangerous to compare the UK with the USA too closely, however, because of differences in culture, geography, pricing and technology evolution and update.
- Although ecommerce has developed in a PC-based Internet environment, new technologies mean new formats are coming on-stream. In particular, emerging mobile phone technologies and interactive shopping via digital television.
- In the UK current estimates for 2000 are less than 0.7% of all retail sales. Official figures from the US indicate that online represented 0.8% of all retail sales in 2000.

Forecasts and the growth of B2B
- Forecasts for the growth of ecommerce vary substantially. This is largely due to the variety of methodologies and assumption adopted by forecasters, and the lack of any standard definitions. Some forecasts for 2003/4 suggest online revenues of over £7bn and users in excess of 27 million in the UK.
- Business-to-business ecommerce is forecast to be a major growth area. Worldwide B2B revenues were $145bn in 1999. The Gartner Group forecast the market to be worth over $7 trillion by 2004.
- The retail industry has been sluggish to adopt online B2B practices. However, two major exchanges have formed, bringing together some of the world’s largest retailers. B2B exchanges have the potential to cut supply chain costs and increase efficiency.
2.1 What is ecommerce?

‘Ecommerce’ is commonly viewed as trade that actually takes place on the Internet, usually through a buyer visiting a seller’s website and making a transaction there. However, the term has evolved from this fairly limited notion to mean all aspects of business and market processes enabled by the Internet and World Wide Web technologies. The impact of the web is global and affects processes within businesses, between businesses and between businesses and consumers. The Cabinet Office (1999) define the term more formally as:

‘the exchange of information across electronic networks, at any stage in the supply chain, whether within an organisation, between businesses, between businesses and consumers, or between the public and private sectors.’

Ecommerce can be further sub-divided into a matrix (Figure 2.1). For example, the largest amount of trade currently is in the business-to-business (B2B) sector, typically for suppliers to large companies such as Ford and General Electric. Most commentators believe this will continue to dwarf B2C for the foreseeable future. The other three sectors (excluding government) are as follows:

- B2C, or business to consumer: including retail activities on the web such as Amazon and Gap;
- C2B, or consumer to business: where consumers bid for goods and services leaving the company to decide which bid to accept;
- C2C, or consumer to consumer: where consumers get together to participate in auctions of goods.

Although ecommerce and ‘retailing’ are relatively new, the Internet has a long history, having been in existence for over 30 years. The driving technology behind ecommerce is the Internet, which includes the world wide web. Developed by Tim Berners-Lee in 1989 the Internet is now a vital part of 21st century life and, in the UK and elsewhere, access to the Internet has increased dramatically for individuals and businesses.

Current worldwide levels of Internet usage are equally significant. In November 2000, Nua Internet Surveys provided an estimate of online users across the world† (Table 2.1). They estimate that there are over 304 million Internet users worldwide, 45% of which are based in North America. Nua have based their estimates on the results of numerous surveys and admit that the figures are ‘educated guesses’. Their data represents the numbers of adults and children

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† [http://www.nua.ie/surveys/how_many_online/](http://www.nua.ie/surveys/how_many_online/)

### Table 2.1 Estimated number of Internet users, November 2000

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of Users (Millions)</th>
<th>% of Users Worldwide</th>
<th>% Change Since March 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>3.11</td>
<td>0.8%</td>
<td>+20%</td>
</tr>
<tr>
<td>Asia / Pacific</td>
<td>104.88</td>
<td>25.8%</td>
<td>+52%</td>
</tr>
<tr>
<td>Europe</td>
<td>113.14</td>
<td>27.8%</td>
<td>+36%</td>
</tr>
<tr>
<td>Middle East</td>
<td>2.40</td>
<td>0.6%</td>
<td>+26%</td>
</tr>
<tr>
<td>Canada &amp; USA</td>
<td>167.12</td>
<td>41.0%</td>
<td>+22%</td>
</tr>
<tr>
<td>South America</td>
<td>16.45</td>
<td>3.5%</td>
<td>+54%</td>
</tr>
<tr>
<td>World Total</td>
<td>407.10</td>
<td>100.0%</td>
<td>+34%</td>
</tr>
</tbody>
</table>

*Source: Nua Internet Surveys*
who had access the Internet at least once over the preceding three months. As expected the developed world has the highest number of users, but it is the developing world that is witnessing the fastest growth, particularly in Asia and South America. Even though there is still substantial growth in North America, the rate is now one of the lowest in the world.

The ability to provide statistics of worldwide Internet usage is difficult, particularly as national statistical agencies are only just changing the way they report and collect this type of data. The World Bank publishes data on the usage of the Internet’s infrastructure: telephone lines, cable subscribers, PCs and Internet hosts. The most recent set of complete figures (1998) are shown in Table 2.2. Telephone usage is similar in most European counties, since this is a well-established communications medium. There is a trend for Southern European countries to have the least number of lines, with Scandinavian counties having the most. A similar pattern is observed for PC ownership, but all EU counties lag behind the US (457 PCs per 1,000 people). The UK (with 263 PCs per 1,000 people) is somewhat behind the European field in this measure, with Belgium, Ireland, the Netherlands and all the Scandinavian counties having greater PC penetration.

In the UK, current unofficial estimates of ecommerce sales are running at less than 0.7% of all retail sales for 2000. The US Census Bureau has also begun reporting ecommerce sales and their contribution to total retail sales. Data collection began in October 1999 and ecommerce sales for 2000 were $25.8bn, representing 0.8% of total retail sales.

Compared with the rest of Europe, the UK has a substantial Internet-literate population. Surveys often argue that the UK lags the US by about 1.5 and 2 years, and that the UK is following the same growth model as the US. However, there are many differences between the two countries that make these assumptions highly questionable. In particular, differences in geography, demographics, regulations, telecommunications systems and the culture of shopping will make Internet penetration rates differ substantially.

However, there is no doubt that the Internet has impacted dramatically on households, businesses and markets in the UK, as the following statistics show.

### 2.2 The growth of the Internet and ecommerce in the UK

#### 2.2.1 Households / Individuals

The number of UK households having PC access has increased from 13% in March 1999 to 32% in December 2000 (ONS, 2000). As far as the population as a whole is concerned, some 45% of adults have accessed the Internet at some time (equivalent to 20.5 million adults) and recent data shows the UK compares favourably with other countries for this measure.

Despite these headline figures, however, there is evidence of a social divide in the UK between both income and age groups. For example, only 3% of poorer households are online compared with 48% of more affluent households. Research by Booz Allen (2000) has shown...
the nature of the ‘digital divide’ quite graphically (Figure 2.3). More recent ONS figures suggest that the current rate of Internet access growth amongst more affluent households is twice that of lower income groups.

Recently the term ‘digital divide’ has received a lot of publicity in the UK. There are concerns that there will be divisions between the ‘haves’ and ‘have nots’ in the digital society and Prime Minister Tony Blair has pledged that all Britons will be able to have access to the Internet by 2005. Various government initiatives have been announced to achieve this goal, including the ‘computers-for-all learning initiative’ which is designed to underpin a national network of computer learning centres.

This has been supplemented by the growth of ‘egateways’ which comprise Internet kiosks, cybercafés and telecottages and similar centres. Shop front gateways, which incorporate cybercafés, have become increasingly common, but the failure rate is high. The three year ‘Virtual Society?’ Research programme, based at Said Business School, Oxford, has recently concluded that:

- the current rate of rapid Internet penetration in the UK may not continue: research shows that teenagers, in particular, get quickly bored by the medium;
- new technologies tend to supplement rather than replace old ones – for example teleconferencing has increased the demand for business travel;
- the main users of public Internet kiosks may be people who already have access to the web at home or work.

The conclusion is that improved access to the web for those who cannot afford to surf from home will not end social exclusion, because egateways are used by those already online. In short, increasing access does not necessarily generate use (ESRC, 2000).

The divide is also clear regionally in the UK (according to ONS data) with the South East (25% of households) having higher Internet access than the North East (14%) for example. This picture of a regional divide is also reinforced by data from CACI (2000), who suggest a figure of 36.3% of the adult population online in the South East of England. Only six cities/towns had in excess 32% of their populations online. These were Reading, London (West End), Cambridge, Edinburgh, Aberdeen and Bristol. At the foot of the rankings were Margate (7.8% online), Clacton (6.7% online) and Wallasey (2.2% online).

PC Internet access continues to dominate in the UK. However, as Figure 2.3 shows, multi-channel access is likely to increase in the future through alternative access routes, such as mobiles and digital TV. The launch of WAP-enabled handsets and services during 2000 has been seen as the first stage in developing mobile access to most of the Internet and as a forerunner to third generation services.

2.2.2 Businesses
In the UK some 81% of businesses are connected to the Internet, up from 63% in 1999 (E-envoy, 2000). There has been a substantial increase in the number of SMEs connected from 15% in 1999 to 55% in 2000. Some 34% of UK businesses also allow their customers to make payment online or pay their suppliers online and this places the UK ahead of other countries such as Germany and USA (28%).
As far as retailers are concerned, Verdict (2000) reported that from December 1999 to June 2000 the number of top 100 UK retailers with websites increased from 61 to 87 and more of these (36 compared with 29) were transactional.

2.2.3 Present and future ecommerce (B2C and B2B) markets

Putting figures on the size of ecommerce (B2C) markets is becoming a little easier as national statistics improve (ONS, 2000). As far as the UK is concerned, data suggests that it is the largest ecommerce market in Europe. For example, Verdict reported that retail ecommerce (excluding cars, travel and financial services) was £0.58bn in 1999 and £1.35bn in 2000 (see section 3.4).

Data from IDC suggests the B2B market in the UK is £0.8bn. According to The Gartner Group, world-wide online B2B activity in 1999 accounted for $145 billion of economic activity. They forecast that by 2004 7% of global B2B transactions will be online, accounting for $7.29 trillion (Reda, 2000). Deloitte Research (1999) predict that by 2002 revenues will exceed $1.2 trillion. B2B ecommerce is therefore set to dwarf the B2C segment, due to the sheer number of businesses and transactions involved.

Reda (2000) suggests that large retailers have tended to shun B2B exchanges, even though they are aware of their advantages. They have been worried about losing some control over the process by switching all their buying and selling online. In addition, many of these companies have gone through a process of investing heavily in supply chain technology during the 1980s and 1990s, to allow their in-store IT systems to communicate with suppliers. Therefore the Internet holds most appeal to SME retailers and suppliers, who have not readily pursued this technology, but who can now make use of a cheaper and more ‘universal’ system.

Every stage in the retail supply chain provides an opportunity for a B2B marketplace. Of particular significance for the UK are two new B2B exchanges – GlobalNetXchange and Worldwide Retail Exchange (Figure 2.2). Both exchanges demonstrate the increasing trend for globalisation within the retail sector. Retail Intelligence (2000) argue that one particular driver has been the need to match the supply chain efficiencies of Wal-Mart. It also clearly a way of cutting costs industry-wide. They should also generate increased choice for consumers, with more suppliers to source from than ever before. There are some key areas where savings can be made:

- Cost effective Internet transactions (including real-time onscreen trading);
- A comprehensive information network;
- Equilibrium between supply and demand;
- Collaborative buying;
- Planning and forecasting;
- Product innovation; and,
- Increased supply bases.

There are also implications for business-to-consumer ecommerce. If these B2B exchanges prove a success, and most supply chains become fully automated, they could provide an...
opportunity for B2C ecommerce to prosper by removing some of the inefficient back-office systems that currently exist.

The USA, however, still dwarfs other markets with some £81 billion in B2C business. Despite this, growth in UK B2C business has been rapid (some 280% between 1999 and 2000, according to the Boston Consulting Group (2000)), although online retailing still only represented less than 1% of the total retail market in 2000.

As to future growth, forecasts for B2C differ widely in the UK and ecommerce forecasting has become a cottage industry. Box 1 shows some examples of varying forecasts.

Figure 2.3 UK/International comparison, mode of internet access and the digital divide

The UK compares favourably internationally...

Internet Users as % of Total Working Population
Online Buyers as % of Total Working Population
Online Spending as % Total Sales (r.h.s.)

USA | Sweden | Finland | UK | Netherlands | Germany | France | Spain | Italy | Portugal


...but there is a digital divide in the UK

By Age
15-24 | 25-34 | 35-44 | 45-54 | 55-64 | 64+

By Social Divide
AB | C1 | C2 | DE

Note: based on data from Booz Allen and Hamilton
2.2.4 UK government and European Union policy
Ecommerce has also been driven by government policy. Since the 1997 General Election, the British government has taken a number of significant steps, led by the Department of Trade and Industry (DTI) and the Cabinet Office. An ‘e-minister’ has been appointed at the DTI and Cabinet Office ministers are co-ordinating the use of the Internet across the government machine. In January 2000 an ‘e-envoy’ was appointed to co-ordinate the government’s approach.

From May 1998 the UK government also began to publish major policy statements on electronic commerce and the ‘information age’. More recently, the Electronic Communications

Box 1 Ecommerce forecasts
UK ecommerce forecasts are normally derived from either demand side estimates, which estimate average spend patterns to derive total spend, or supply side estimates, which use total sales figures to forecast market size. Inevitably, each method will give a different result because UK consumers spend globally and overseas, leading to spending ‘leakage’, and because UK suppliers themselves also supply globally. Sometimes a ‘hybrid’ form of forecast is used which combines both demand and supply. Users of forecasts should pose key questions of any forecast such as:

- What is the geographic scope?
- Who has carried out the survey, and why?
- How are ‘online sales’ defined – are they retail goods or do they include services such as travel?
- How is ‘Internet user’ defined – does it include work use?
- What does it mean to ‘shop online’ – is it only transactions or does it include browsing?
- Does the survey include B2B sales and B2C sales?
- Is the forecast demand (consumer) or supply (retailer) based?
- Future growth assumptions are also contingent on the way such key issues as the following are addressed:
  - The extent to which the nature of different product types influences online consumer buying habits (i.e. it is generally agreed CDs and books are highly suited to online buying)
  - How alternatives to online buying (such as retailing and direct marketing) go to make up the multichannel mix
  - The degree to which Internet sales are incremental (i.e. a new online sale that would not have occurred otherwise) or cannabalised (i.e. taken from the offline channel)

Reliable data on online usage and spend is becoming more easily available through national government agencies such as the Department of Commerce in the USA and Office for National Statistics in the UK. This sort of data is important for benchmarking exercises, and from 2001 ONS will start to release online spend figures through the General Household, Time Use and Family Expenditure Survey results. In the USA, the National Retail Federation (NRF) and Forrester also produce an online retail index which measures the growth of online shopping.
Bill received Royal Assent in May 2000. The main effect of this legislation is to make digital signatures legally binding and allow the creation of an accreditation scheme for electronic signing. The aim of the legislation is to improve trust amongst the public and business about electronic trading, thereby attempting to ease security concerns amongst users. Other important legislation in this area includes:

- The Regulation of Investigatory Powers Bill, which contains provisions for the police to demand codes to decipher encoded electronic messages
- The Consumer Protection (Distance Selling) Regulations 2000, which apply to contracts entered into at distance. The regulations feature a seven day ‘cooling-off period’ during which the consumer can cancel the contract for any reason (Lovells, 2000).

The main legislative activity in Europe is the EU Electronic Commerce Directive (98/0325). The first draft of the directive was adopted by the European Commission in November 1998, and revised in August 1999. It was formally adopted by the Internal Market Council in February 2000, and by the European Parliament on 4 May 2000 (Hargreaves, 2000). The directive sets out the legal framework for European ecommerce and should be integrated into national laws by November 2001. The directive will allow Internet traders to offer goods and services anywhere in the EU, providing the laws of their home country are followed. There are also measures to protect consumers with rules on electronic contracts, email advertising and online discounts.

2.3 Retailing and ecommerce

2.3.1 Forces of change in retailing

Retailing has always been about attaining the right balance and getting the right product in the right place at the right price at the right time. Fulfilling this requirement has changed throughout the history of retailing as a result of ‘disruptive technologies’, such as department stores, mail order, discount stores and most recently Internet retailing.

The Internet is different because it enables retailers to combine what was previously unattainable by delivering high value (in terms of selection and service) at low cost (and price). In the past, as Figure 2.4 shows, it has been very difficult for retailers to do this: there was a trade-off between price and ‘service’. Now, however, the Internet provides retailers with an unsurpassed opportunity to provide customers with a highly targeted service at low price.

Ecommerce poses both a threat and an opportunity to conventional ‘bricks and mortar’ retailers. What, though, has contributed to the growth of ecommerce? The web’s global reach, ease of price comparison and greater choice are all key advantages. However, websites are not able to reproduce the social function of shopping or of browsing, or of producing the impulse purchases of shopping centres. The Internet may also work better for replacement buys than new purchases. But the rapid growth of the Internet and its impact in retailing must also be viewed against a backdrop of some very fundamental changes that have affected the retail landscape during the 1980s and 1990s.
Changing work and leisure trends

The disruptive technology of the Internet in retailing comes not only at a time when consumers are becoming more sophisticated in their needs, but also when the retail trade itself is facing severe pressures.

People still shop for a variety of reasons. Research from the USA (Tauber, 1972) suggested that personal motivations for shopping included role playing, recreation/diversion, self-gratification, sensory stimulation and, amongst the social motives, peer group attraction and communication. As Tauber observed, ‘As businesses which offer social and recreational appeal, retailers must acknowledge that they are competing directly for the consumer’s time and money with other alternatives that provide similar benefits’.

This is certainly true today as time pressures have increased, particularly during the 1990s. Ironically, research also shows that although the time spent on paid work has decreased, the time spent on shopping and childcare and some leisure pursuits (eating out, cinema and pubs) has increased. ‘Unpaid work’ (which includes shopping) is therefore taking a larger proportion of people’s time, perhaps driven by shopping self-service and the greater distances travelled (Figure 2.5).

The trend towards increased leisure is reflected in spending patterns. For example, the UK has seen an increase in expenditure on leisure of 2.89% per annum for the period 1971-97 (see Figure 2.5). Allied with this is that the proportion of expenditure on consumer goods is falling with more spent on leisure. In general, this reflects a long-term shift away from spending on basic necessities such as food and housing towards leisure-related goods. Shoppers’ behaviour is also changing and shopping no longer has quite the ‘conspicuous consumption’ image it had in the late ’80s. Shoppers are increasingly price-conscious and perhaps even less brand-conscious than they used to be.

Demographic changes

Currently the UK proportion of over 65 year olds is 17%, but by 2020 could be as high as 25%, with one third of those over 80. This has important repercussions for retailers in the UK:

- the proportion of younger people will diminish, with a resultant impact on sales of toys, games, and same apparel/footwear sectors;
- the middle-aged population will take off dramatically; and
- the number of single-person households will continue to rise substantially because people marry later or not at all.

In addition couples are deferring parenthood, so that spending patterns differ further. Government estimates forecast the formation of 4.4m new households to 2015, of which 75% will be single person households. Family structures are changing as more women work in the UK, and it can be seen that the attractions of home shopping and convenience shopping are becoming very important.

**Decreasing number of shop units and an increasing concentration of sales**

The number of small, single independent retailers has fallen in the UK in parallel with their market share. In contrast, multiples have increased in number and have increased their share in turnover. The total number of shop units has also fallen from 332,819 in 1990 to 292,518 in 2000 (Verdict, 2000) (see Figure 2.5).

In addition, UK superstores and hypermarkets have increased in number from 457 in 1986 to 1,102 in 1997. This has led to an increasing consolidation in retail sales: the top 10 retailers combined to account for over 40% of the total turnover of the top 800 retailers in 1998/99, for example, compared with 32% in 1986. This is also true at a sectoral level except in clothing where increased competition has reduced the market share of M & S for example.

Evidence of further consolidation at store level is provided from research by Healey and Baker (cited in ABN-AMRO, 2000) which showed that for a retail chain to access 50% of UK comparable goods spend, required to trade from 250 stores in 1971. By 1976 the number was down to 75, and by 2010 it is expected to be 40.

Despite these trends towards greater consolidation in the UK retail sector, extensive chains of small shops have also been developed by large retailers, either as new products (i.e. The Link), or through merger. Arcadia, for example, has more than 2,500 outlets in the UK trading through 16 formats developed as individual brands. These small store formats have a relatively short lifecycle of 5-8 years and so require frequent redesign and redevelopment.

**Evidence of falling real sales densities in the early 1990s, deflation and lower margins**

Verdict (2000) suggest that from 1990 to 2000 average sales densities in the UK have risen by 41%. But neighbourhood shops have improved by only 16%, with out-of-town up by 54% and in-town up 39%. However, in inflation-adjusted terms, real sales densities declined for all but out-of-town in the early 1990s, before rising again in the period to 2000.

However, the picture is by no means clear-cut. The sectoral view also varies. Groceries and electricals have the highest sales densities and during the 1990s they have steadily increased. The surge in sales density within the electrical sector can be attributed to the rapid increase in sales of computers and mobile telephones over the period from relatively small retail units. Clothing and DIY have the lowest sales densities and for some retailers in these sectors sales densities have remained static or have fallen.

Price deflation in some sectors comes at a time when UK retailers’ margins are also being squeezed. According to Datastream (quoted in BRC Shopping in Britain), over the last 10 years the average net margin of 8.7% for retailers compares with 9.5% for leisure and hotel
operators and 12.5% for brewery, pub and restaurant operators. Food retailers’ margins are even lower and show a decline over the period 1996-2000 (Figure 2.6). These have come in for even greater scrutiny recently with the Competition Commission’s report on supermarkets.

The fall in sales value has been exacerbated by the fall in the level of retail inflation. In both 1998 and 1999, for example, the increase in volume was greater than the increase in value of clothing and household goods, indicating a general deflation in prices in these sectors (Figure 2.6). Data from the British Retail Consortium (BRC) suggests that shop price inflation was lower from July 1989 to July 1999 (31%) than overall inflation (43.1%). More recently, the BRC’s Shop Price Index (a specific measure of inflation focusing on 200 commonly bought items) showed a decline in prices of about 2% from November 1997 to August 2000. This downward movement is also echoed in the official RPI index (excluding mortgage interest payments) statistics. At the end of 2000 official figures suggested the British economy is now in the most sustained period of low inflation since the Great Depression. In December 2000 the annual inflation rate was 2.1%, the lowest figure since records began. In addition clothing and footwear prices are falling by an annual average of 3.8%, the biggest fall since 1949; household goods by 0.9%, the biggest fall since 1959 and food prices by 0.3%, the biggest fall since 1960.

Indeed, Bank of England reports have recently suggested that retail goods prices in other sectors may have been reduced by the impact of competition and price transparency on the

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**Figure 2.6 Falling inflation and falling margins in UK retail**

Falling inflation is a feature of UK retailing, with deflation in some sectors...

... and margins are falling...

UK Supermarkets

- Rate on Capital Employed
- Gross Operating Margin

Source: BRC

Source: Competition Commission (2000)
Internet. Research from the USA also appears to confirm this (Brynjolfsson and Smith, 1999) but this picture is by no means uniform across all product lines.

**Increasing globalisation**

The saturation of domestic markets and the desire for growth have fuelled increasing globalisation in retailing through self-start, merger and acquisition and franchising. The increasing merger activity in the retail sector has also been partly driven by global shortages of real estate available to retailers to build stores, particularly with strong growth restrictions in Western Europe.

Wal-Mart’s acquisition of Asda in 1999 is seen by many as an indicator of the structural and global shifts that will impact on retailing over the next decade. The company’s operating philosophy of low prices and high stock rates is at the heart of its strategy and its effect is likely to be felt beyond simply grocery sales.

Despite the apparent level of increased competition, other evidence suggests that large retailers are growing at a far faster rate than the market as a whole, at least measured by sales volume. In 1998 there were 12 European companies with sales of over US$25 compared with 8 in 1997. Of those companies with sales of over $20 billion, 17 had increased their sales by more than 100% during the 1990s. Although extensive multinational operation is not necessarily a feature of these companies, low growth companies are characterised by operation in a limited number of countries. In turn, the saturation of domestic markets in the UK and the development of the EU have led UK retailers to develop outlets in other countries. Similarly European retailers have sought to enter the UK market and prime examples have been Mango and Zara, two Spanish retailers.

**2.4 Summary**

The Internet is not a new phenomenon and, as a ‘disruptive technology’, comes as part of a long history of innovations in the retail sector. The Internet’s rapid growth, scope for cost savings and price transparency in retailing offer a threat to conventional store-based retailers.

The growth of ecommerce is being driven by the rapid growth in Internet access both in the UK and globally. The UK’s relatively high degree of PC and Internet access penetration, driven partly by the Government’s desire to see the UK as a global ecommerce leader by 2005, has led to many forecasting huge surges in ecommerce trade over the next 4-5 years. However, such forecasts vary and are based on a variety of methodologies and assumptions. They also overlook the very real digital divide that is emerging spatially and within society, as Internet access levels differ dramatically between income/social groups and regionally around the UK.

Currently the amount of retail trade conducted online is less than 1% both in the UK and the USA. Business-to-business ecommerce will probably dominate over the next 5 years and is seen by many as the tip of the ecommerce iceberg.

Although ecommerce is a powerful force for change in retailing, its growth must be seen in the context of equally powerful forces, which include changing work and leisure trends, demographic changes, increasing consolidation in retailing, falling sales densities, deflation and lower margins, and increasing globalisation. The Internet itself may well be playing an important role in driving down prices through greater price transparency.
3 CHANGING PATTERNS OF ECOMMERCE AND RETAILING

Key Points

Key players on the stage

- **The competitive landscape of ecommerce is in constant flux:** currently the main players range from ‘search engines’ through to Internet stores and shops.

- **Battle lines have been redefined.** The choice is between multichannel shopping or trading solely in either a physical or online world.

What sells on the Internet?

- **Goods that have a high touch and feel factor are less suited to the web than goods that have a low touch and feel factor.** Product characteristics, familiarity and confidence and consumer attributes can be mapped to test a product’s suitability for online selling.

The retailers’ response

- **Retailers have differed in their strategic response to the impact of ecommerce.** Some continue to use it as an ‘information-only’ add-on, and others have combined both online and a physical stores approach in a ‘multichannel’ model.

Is the future of store-based retailing at risk?

- **The economics of store-based retailing means that a reduction of 15% in trade could plunge some stores into loss-making positions.** Our analysis of some major high street names suggests that at low margins, even losses of 5% plus could adversely affect profits.

- **Many dot.com companies have performed badly during 2000, and their financial position has been challenged by many commentators.** With high cash burn rates and overpricing in the markets, the bubble may well have burst.

- **Retailers who incorporate an online channel face increasing questions about customer fulfilment and delivery.** Innovative ideas to solve logistics problems on the UK’s already overcrowded roads include collection/delivery points at petrol stations, edge-of-town locations and convenience stores.

Future technology paths

- **Compelling evidence points to a multichannel future for shopping.** Consumers are modal and want choice. Digital TV is likely to play a much more important role in the future.

3.1 The key players on the stage

Against the backdrop of the trends outlined in the previous section, new players have started to enter the retailing fray.

In fact the ecommerce market is currently a hotbed of competition and a power struggle between ‘pure-plays’ (the dot.coms) and more conventional, ‘bricks and mortar’ retailers. There are also many retailers who have combined physical stores with an online channel, the so-called ‘bricks and clicks’ retailers. Consumer goods manufacturers and retailers are also
fighting with newcomers for strategic positions in the convergence industries and emerging portals and market makers are also joining in battle.

The current situation can be summed up by dividing competing groups according to whether they:

- sell products to consumers;
- arrange transactions; or
- facilitate market entry.

This is shown in Figure 3.1. The main players within these groups are:

- Internet stores;
- virtual shopping centres;
- auction houses;
- intelligent agents (or price comparison services);
- Internet service providers; and
- search engines.

Internet stores are the most prominent of these groups. Selling direct to the customer they are direct competitors for high street stores and mail order companies. Amazon and Dell are two good examples, Amazon particularly so as it not only sells books but has diversified into a range of other goods as well.

There have also been attempts to develop virtual shopping malls, based on the physical mall or shopping centre model. Examples include Shoppinggate and the Knot.

One of most successful recent developments has been the arrival of web auctions. These comprise two main types: firstly, B2B auctions at which stock is sold between retailers and manufacturers, and secondly, C2C auctions where individuals trade between one another. eBay is the main exponent of this and has its own business system, acting like a broker, and currently accounting for some 15% of all parcels delivered by the US postal system.

More recently, intelligent agents or ‘bots’ have entered the scene. These provide a price comparison service for shoppers on the web, basing their market impetus on the availability of transparent price information on the web. Examples here include MySimon and Deal Price.

There are other groupings which facilitate market entry, including the major search engines (Yahoo, Lycos, Excite, AltaVista or Infoseek). Yahoo is probably the most successful of these as it offers a range of other services (e.g. stock market information) which make the site ‘sticky’ to retain customers and so increase potential advertising revenue.
Internet service providers (ISPs) such as AOL have also found niche markets in this competitive landscape. Strategic alliances have been formed with other organisations (recent merger of AOL and Times Warner).

However, the boundaries between these groups is blurring as the Internet race develops and convergence of industries takes place in the fight for direct customer contact.

Who ultimately wins the battle between the dot.coms and the bricks and clicks retailers (who are using real assets married with ecommerce) is the subject of hot debate. The recent troubles associated with dot.coms seems to have tilted the balance in favour of bricks and clicks retailers, however, and the accounting picture for most dot.com retailers makes gloomy reading. Recent casualties include:

- Eve.com – the online fashion and beauty retailer,
- Boxman – the European music retailer,
- Boo.com – an online sports and leisurewear retailer, and
- Clickmango – a health and beauty retailer.

In addition the online toy retailer eToys ceased operations in Europe after Christmas 2000.

Debenhams recently conceded that it would take eight years for its Internet sales operation to generate the same profit as one new high street retail outlet. The Debenhams ecommerce operation, which was recently voted the best retail website operated by a high street chain, received £5m in investment, but it will not break even for 4 years, and is being used as a method for driving overall sales.

### 3.2 What sells on the Internet?

Perhaps the two key advantages of the web from a consumer’s point of view are the ease of price comparison, allied with greater choice. The former has been made even easier recently by the development of ‘price agents’, which compare prices. But, although the web’s reach is global it is not so good at:

- replicating the social function of shopping;
- producing serendipity or impulse purchases that might come from a shopping centre visit;
- providing instant gratification that many shoppers expect.

The web also seems to work better for replacement purchases than for new purchases.

It also seems to work less well for goods that are ‘high touch’ (e.g. clothes, shoes and groceries) than for those that are ‘low touch’ (e.g. computers, CDs (see Box 2) and books). In general ‘low touch’ items have sold best on the web so far (see Figure 3.2).
Box 2 Case Study: Music Online

Music sales in the UK have expanded rapidly during the 1980s and 1990s. Total album sales in 1999 were nearly £1 billion with CDs by far the most popular medium. The dramatic increase in CD sales has been accompanied by falls in the sales of cassettes and vinyl. Music is today very much a consolidated industry with five labels controlling 85% of global sales. In the USA, 0.13% of releases generated more than 25% of total sales revenue.

Recent research by Angus Reid (2000) has shown that some 36% of adults have downloaded music from the Internet. This overall figure, however, hides a number of features, not least of which is the relatively high percentage of younger Internet users downloading music. World-wide, the figures also vary, South Korea and USA having the highest extent of music download use on the web.

This is a recent phenomenon, driven by new technological initiatives, such as the MP3 file (or MPEG audio layer 3) which offers near CD quality in a small file. This uses up much less space than typical audio files and also enables users to capture, store and exchange files on the web, or in their CD collections. A number of products have been developed to make exchange easier, including Napster, Scout, Gnutella and Nullsoft. The free exchange of copyrighted works is of course illegal, but sites such as MP3 and eMusic have agreements with record labels to sell and distribute pre-recorded music.

At the moment, is too early to say what the overall effect on music will be. As to the future, opinions differ. Jupiter (2000), for example, suggest that by 2005 online music spending will comprise 24.6% of industry sales. In addition, 28.2% of this will be in the form of digital downloads, compared to just 1% in 1999. Bricks and mortar retailers therefore face two threats:

- Sale of music by online retailers and record companies; and
- Digital downloads.

How are retailers responding to this? Some retailers, such as Tower Records, have made music tracks available for download, whilst others such as Virgin and Barnes and Noble have equipped stores with kiosks to make custom-made CDs. However, at the moment the track selection is limited and recording time can be up to 20 minutes. More recently still, Warner Music has announced it will be selling music on the web through online retailers such as Walmart.com and Amazon.com.

Retailers who use new technology to reinvent their floorspace with multimedia and CD-burning kiosks may be able to compete, but can themselves face competition from kiosks located anywhere.

At the moment it is not clear whether online sales are cannibalising sales from traditional retailers or record clubs. The big five record companies are, however, all considering plans to offer limited digital downloading of music. This is likely to mean the music downloaded will fall in price but this could be offset by increased sales of music. Aside from one-off payments, the eventual model for digital download may be subscription based, but finding a solid way of protecting intellectual copyright will prove a major challenge.

Ultimately, if digital distribution is going to succeed, any future system must protect intellectual property, be as easy and ubiquitous to use as possible and offer value to the listener, through convenience and cost savings with more music choice and better music information.
Such a broad division may be too crude, and distinctions may be blurring: for example, catalogue retailers have sold clothes very successfully without buyers trying on clothes, and the Internet has in some cases showed moves towards ‘virtual fitting’ and ‘digiscents’ (see Box 3).

As a general rule, however, products or categories which are particularly suitable for online retailing are those which:

- have a built-in quality standard and so do not have to be physically checked by the customer when making the decision to buy (e.g. music and many strongly branded goods);
- are context sensitive and so need explaining, where ancillary information is valued (e.g. travel and health);
- have high potential for reduced transaction costs through cheaper sales and distribution costs (e.g. clothing and software);
- can use customer feedback to enhance and tailor the product for the customer (e.g. computers and cars);
- have high profit potential per unit (if shipped).

De Kare-Silver (2000) used an Electronic Shopping (or ES) test to provide a simple guide as to which products can be readily sold on the web. The three steps in the test are:

- product characteristics: the innate set of characteristics that appeals to the consumer’s senses through sight, sound, smell, taste and touch;
- familiarity and confidence: the degree to which the consumer recognises and trusts the product, has tried it before and is confident about repurchasing it (i.e. branding);
- consumer attributes: the underlying motivations and attributes towards shopping of consumers (i.e. receptive or not to electronic shopping).

These characteristics are summarised for a range of goods and services in Figure 3.2, which shows books, household goods, insurance and banking all have a high ES potential.

### 3.3 The retailers’ response to ecommerce

Retailers have adopted a variety of strategies to cope with the impact of ecommerce.

De Kare-Silver (2000) uses a helpful classification of these responses:

- ‘Information only’: a limited response and one which provides information, for example, on retail outlets, methods of purchasing and so on (e.g. B&Q website);
- ‘Export’: again limited, but with an online transaction presence for a specialist sector, for example, overseas sales (e.g. Blackwells);
- ‘Subsume into existing business’: the emphasis here is not on changing existing retail operations but on integrating or subsuming ecommerce into the existing systems (e.g. Safeway’s ‘Collect’ scheme);
- ‘Treat as another channel’: retailers using this strategy maintain a separate ecommerce sales channel but keep it as part of the existing business sharing overheads, systems, back-office functions and personnel with the parent company. Some retailers have also used host ‘malls’ provided by portal companies;
‘Set up as a separate business’: this model does recognise that a different business can be created without cannibalising existing sales;

‘Pursue on all fronts’: this model rests on the belief that some retailers want to pursue every available channel, meeting all target consumers and being as competitive as possible (e.g. Great Universal Stores);

‘Mixed system’: this combines ‘flagship stores with online delivery’, with the stores acting as brand name promoters complementing the online direct selling operation. This recognises the importance of showcasing brand strength but reinforcing it with an efficient and fast order and delivery service;

‘Switch fully’: no major physical retailer has switched fully from bricks and mortar to online. Argos is a good example of a high street catalogue retailer which is leaning rapidly that way (Argos was acquired by GUS in 1999). Pure-plays such as Amazon and 1-800-Flowers of course are able to switch fully.

In addition, De Kare-Silver suggests there are two other strategies which ‘buck the trend’ and effectively defend, yet exploit, existing real estate and retail core competencies. These comprise:

‘Best of both’: this means that all real estate is retained but that it is ‘reinvented’ to provide products, services, an entertaining environment as well as facilities that consumers want. The new technology is very much a part of this environment enabling integrated Internet orders and collections/delivery;

‘Revitalise and buck the trend’ (‘Leisure and retail’): this concedes no ground to the Internet and is designed to defend existing real estate by making shopping an improved leisure experience.

The various strategic options are shown in Figure 3.3 which overlays the strategies against the relevant product/consumer mix of individual retailers.
3.4 Size of the UK ecommerce market

The strategic responses of retailers to ecommerce have led to rapid growth in key product sectors. But although rapid growth of online sales has been a feature in the UK from 1999-2000 (an increase of 130% according to Verdict), the figures are still only relatively small. For example, online retail sales (excluding services) in the UK were only £0.58bn in 1999 (comprising 0.29% of total retail sales). In 2000 Verdict put the figure at £1.35bn (or 0.7% of retail sales). This is expected to grow by 21 times to £12.5bn at current prices by 2005. However, this would still only comprise 5% of all retail sales and growth will be most rapid in computer software, music and video and books.

The impact on the retail sector could be substantial, however, because Verdict believes that only 6.5% of the growth will be incremental (the balance will be trade switched from physical stores). On margins of 5% or so, if sales volumes fall by 3%, retailers have to become still more efficient to protect their bottom lines.

Figure 3.4 Growth of UK ecommerce

Adapted from public domain data at www.verdict.co.uk
One of the main reasons for the rapid growth in UK online shopping is the increase in the number of online shoppers and their spend levels. Verdict suggests, for example, that 8% of the UK adult population shopped online in 2000, more than double in 1999 with spend levels up 18%.

Boston Consulting Group’s research (2000) suggests that ‘corporate inertia’ has affected some store-based retailers who have treated the Internet simply as another sales channel rather than a new business model. Moreover, almost all pure-play and direct retailers offered a financial incentive to shop online, but, in contrast, less than one third of store-based retailers did the same, perhaps fearing cannibalisation of existing sales. The research suggests that those companies that are successful will be the ones which focus on improving and mastering the total shopping experience online.

A key issue will be customer fulfilment, where mail order companies have an in-built advantage. Interactive TV shopping and mobile phone channels will become increasingly important at the expense of the PC. Despite the growth of online shopping there are three main barriers for people coming online:

- non-shoppers see themselves as less skilled with computers;
- they do not perceive online shopping is cheaper;
- substantial proportions of all groups are concerned about security.

On the other hand, the Internet is seen as better than the high street for convenience, getting hold of unusual products, and for cost effectiveness. The high street is viewed as better than the Internet for having trust in the retailer, and for getting help and advice for the range of products available. Interestingly, however, 66% of all Internet users surveyed in the Verdict research believe it will replace physical shops.

### 3.5 Bricks versus Clicks: are the models sustainable?
#### 3.5.1 Is the future of store-based retailing at stake?

Clearly the Internet has substantial benefits for retailing but also poses considerable threats. Readily available price information, global reach and the prospect of lost trade to the Internet are all concerns for store-based retailers. Given the economics of store-based retailing it may only take a reduction in store traffic of 15% (or about £3 billion of UK retail trade) for stores to be plunged into a loss-making position.

To show this point more strongly we selected 14 retailers ranging from supermarket chains to clothing multiples and one international retailer. Building on research by PricewaterhouseCoopers (Sinden and Miles, 1999), an analysis of the retailers’ balance sheets was carried out. Three of the retailers were the most vulnerable, with a loss of turnover of less than 15%.

| Table 3.1 Impact of 15% of consumers buying electronically on store margins |
|-------------------------------|-----------------|-----------------|
| CURRENT | 15% REDUCTION |
| Store sales | 100 | 85 |
| % cost of goods | 75% | 76.5%* |
| Actual cost of goods | 75 | 65 |
| Gross margin | 25 | 20 |
| Fixed costs | 20 | 20 |
| Net operating margin | 5 | 0 |

* This includes reduced manufacturer discount as sales fall. After De Kare-Silver, 2000
than 5% needed to turn profits into losses. In general the larger, well-established high street names, as well as those retailers with large product ranges (e.g. department stores) show the greatest vulnerability (Figure 3.5).

In contrast, those retailers with a strong, valuable brand show the least vulnerability. It is these retailers who are also actively developing their non-store based retail activities, either through home shopping or ecommerce (Box 3). These new forms of multichannel retailing are being exploited by retailers in order to offset the potential losses that pure-play etailers may induce. Additionally, forecasts suggest that online clothing sales will take a smaller market share than other products such as books, computer software and music.

Against mounting evidence of cheaper retail prices on the Internet and the suggestion that the Internet is in fact driving down high street prices, there is little wonder that those involved in retail property are expressing concerns. This, despite the plight of dot.coms and the negative press etailing has recently received. The reduced trade could lead to reduced margins and hence reduced ability to pay rents.

### 3.5.2 Is the etail model sustainable?

**Financial Performance**

If the economics of conventional retailing has been questioned, the economics of pure-play etail now also faces challenges. Despite the brave new world of the Internet, dot.com companies have come under close financial scrutiny, and their once vaunted financial performance has received setbacks. Irrational exuberance in the stock markets has led to analysts question-
Box 3 ‘Bricks v Clicks’ and ‘Reverse Convergence’

Recently the debate in ecommerce has crystallised around the issue of whether it will be ‘bricks and clicks’ retailers or ‘clicks-only’ retailers (‘pure-plays’) which will succeed. The massive downturn in investor confidence in dot.coms has not helped clicks-only retailers, who have to spend heavily on advertising to get their message over.

Traditional bricks and mortar retailers have also been fighting back. Verdict (1999) report that of the top 100 UK retailers, only 9 do not have a web presence and 42 now have transactional sites. Despite such innovations as Digiscent’s ‘scent-based software’, virtual clothing stores and virtual shopping malls, conventional retailers who combine store-based retail with the online channel have a compelling attraction.

Key barriers to ecommerce online continue to revolve around security issues, payment and fulfilment. The National Consumer Council (2000) found that the inability to touch goods, security risks, and reliability of supplier were all major factors restricting use not only amongst all shoppers but also amongst those already using the net. Some 85% of consumers in the survey also believed the high street was still the ‘safest’ way to shop. The report also points out that the normal method of online payment is by credit card but almost 50% of the UK adult population do not have one.

Such barriers are a powerful driver for ‘reverse convergence’ as retailers move towards retail, and etailers move towards retail. Amazon is a case in point: despite a successful ‘1-click’ order website the company has been ramping up its distribution and office space in USA and Europe.

A physical store presence also offers etailers a number of advantages (Jones Lang LaSalle, 2000):

- Cheap advertising (pure-plays spend twice as much on advertising marketing and public relations (41% of sales) as clicks and bricks retailers (21%);
- Attractions of point of presence in a shopping centre; and,
- Enhanced customer satisfaction through improved trust and security.

Amazon’s 1-Click service is renowned...

...Digiscents for a sensory experience...

...Can online clothing really take off?...

...3dshopper.net a virtual shopping mall...
ing the long term performance of pure-plays many of whom are still unprofitable and whose cash burn rates (i.e. cash operating expenses – gross profit divided by cash at hand and at bank) are worryingly high (Figure 3.6).

Certainly, in the heady days of dot.coms, perhaps the long-run investment potential of pure-plays was overplayed. Schiller (2000) gives an example of what he sees as mispricing in the market. eToys was established in 1997 to sell toys over the Internet. Shortly after its Initial Public Offering in 1999 its stock value was $8bn, which exceeded the $6bn value of the traditional bricks and mortar retailer Toys ‘R’ Us. Yet in 1998 eToys sales were $30m and Toys ‘R’ Us sales $11.2bn, some 400 times larger. Likewise profits of Toys ‘R’ Us were $376m but those of eToys were a negative $28.6m. By January 2001 the company announced that it was to close down its UK operations (Edgecliffe-Johnson & Barker, 2001).

The case of Amazon is also interesting and raises important questions on the treatment of sales densities for etailers. Generally, etailers tend to lease office and distribution space rather than own it. For example Amazon does not own any real estate – it leases all its portfolio, including the headquarters in Seattle. Box 4 gives a breakdown of Amazon’s portfolio and sales data (unfortunately UK sales are not specified), and those of Peapod, a US grocery delivery service.

Figure 3.6 Under the spotlight: pure-play etailers

Perhaps surprisingly Internet pure-play etailers are in a minority on the Web…

Cash burn rates have improved since December 1999 but are still high…

…and recent tech stock performance has dipped…

The pure-plays still show signs of financial difficulty…

Note: data from dotcom.com

Note: Data from PricewaterhouseCoopers (1999)

Source: Bloomberg, Fletcher Advisory

Source: PricewaterhouseCoppers

BCSC

THE IMPACT OF ONLINE SHOPPING ON UK RETAIL PROPERTY

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If, however, total leased floorspace is used to calculate sales densities for etailers, Amazon and Peapod compare to UK DIY and furniture shed retailers. However, it could be argued that that etailers’ revenue-generating space comprises the offices which house companies computers and servers.

**Fulfilment**

Etailers have also faced increasing questions on fulfilment. If etailers are to succeed then two key barriers to overcome are security and trust. These two issues have dominated consumer surveys in recent years. A National Consumer Council (2000) report found that, although the Internet offered the consumer key convenience advantages (avoiding the need for travel, fast and easy price comparison and home delivery), security risks such as the holding of personal information (credit cards) and reliability of the supplier were key disadvantages. Moreover, although the norm for online payment is by credit card, some 50% of the UK adult population do not have a credit card.

More recently, customer fulfilment and delivery has also featured high on the agenda of concerns as dot.com companies come under the investor’s spotlight. A survey by Trading Standards Officers (2000) found that 38% of orders from UK-based etailers did not arrive within the time specified (17% did not get there at all because of system crashes, companies disappearing and so on). This is also borne out by a survey by DHL which found that only 20% of goods ordered on the Internet reach the consumer within the promised time.

### Box 4 Property occupied by etailers

**AMAZON.COM**

<table>
<thead>
<tr>
<th>FLOORSPACE (SQUARE FEET)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>US office space</td>
<td>730,000</td>
</tr>
<tr>
<td>European office space (UK &amp; Germany)</td>
<td>121,000</td>
</tr>
<tr>
<td>Total office space</td>
<td>851,000</td>
</tr>
<tr>
<td>US distribution space</td>
<td>3,800,000</td>
</tr>
<tr>
<td>European distribution space</td>
<td>690,000</td>
</tr>
<tr>
<td>Marston Gate distribution centre (UK)</td>
<td>500,000</td>
</tr>
<tr>
<td>Total distribution space</td>
<td>4,990,000</td>
</tr>
<tr>
<td>TOTAL space</td>
<td>5,841,000</td>
</tr>
</tbody>
</table>

| Net sales ($000s) | $1,639,839 (£1,015,175) |
| Net sales per square foot | $281 (£74) |
| Net sales per square foot office space | $1,927 (£1,193) |

**PEAPOD**

<table>
<thead>
<tr>
<th>FLOORSPACE (SQUARE FEET)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate office (Skokie, Illinois)</td>
<td>49,086</td>
</tr>
<tr>
<td>Warehousing (Niles, Illinois)</td>
<td>70,958</td>
</tr>
<tr>
<td>Warehousing (Union City, California)</td>
<td>46,104</td>
</tr>
<tr>
<td>Total leased space</td>
<td>166,148</td>
</tr>
<tr>
<td>Net sales ($000s)</td>
<td>$73,134 (£45,275)</td>
</tr>
<tr>
<td>Net sales per square foot</td>
<td>$440 (£272)</td>
</tr>
<tr>
<td>Net sales per square foot office space</td>
<td>$1,490 (£922)</td>
</tr>
</tbody>
</table>

Source: SEC filings

US$ 1 = £ 0.61907
The idea of delivery to convenient local points is not new: French mail order company La Redoute has for some years delivered goods for collection at laundrettes. More recently, eetailing initiatives include:

- Kozmo in the USA, who have committed $150 million to pay Starbucks coffee chain to use its outlets as drop off points for video rent collection;
- Waitrose UK delivers to large office blocks, where business employees have ordered goods;
- Dropzone1 in the UK is developing a network of collection points located in Jet and BP petrol stations and Londis and Spar convenience stores. It aims to have 5,000 points by September 2000 and will only handle small parcels for a £1 add on fee. Fulfilment partners get 20p of this in return.
- Collectpoint has linked with T&S Stores Group and will deliver goods to its 1,300 UK outlets. The chain’s 900 convenience stores will be renamed ‘One Stop’.
- Modus Property (based in Manchester) are building a network of drive-through pick up points, called ‘e-stops’, on the edge of large UK towns.

As the market develops, so eetailers have to consider whether to outsource or handle fulfilment in-house. Amazon and the Internet Bookshop keep a tight control of the delivery process but outsource the delivery. With the advent of m-box (in partnership with Express Dairies), retailers may be tempted to go down the outsourcing route. M-box offers order processing by telephone, fax, Internet, interactive TV, mail or milkman, and delivery is made by milk float, courier, postman, or the corner shop. Already Superdrug have announced that they will make use of m-box to deliver some of the products ordered on their website (Fletcher, 2000).

### 3.6 Future technology paths in ecommerce

Aside from the issue of the size of future ecommerce markets in retail, there is much debate over the path that future technology will take. Although ecommerce has primarily developed via a PC-based Internet, future growth is likely to come from a variety of communication media: television, fixed line and mobile telephones. The DTI/Spectrum report (1999) provides a useful conceptual framework for visualising these different development paths (see Figure 3.7).

**Figure 3.7 Routes to the Information Age**

![Figure 3.7 Routes to the Information Age](image-url)

Source: DTI/Spectrum, 1999
Research by the Henley Centre (2000) has focused on the multichannel nature of e-tailing. The research examined customer preferences and attitudes to a variety of communication channels, the trends in their use and how development may be shaped in the future. The main findings were:

- Most consumers are pragmatic and only adopt new technologies once they can be easily fitted into their lives. The research found that consumers are driven by everyday needs and wants. Time constraints and customer needs are powerful drivers, however, to find ways of saving time through convenience or paying bigger dividends on time invested (i.e. buying on the Internet).

- The Internet is going mainstream, and users are enthused with the medium. ‘Wired families’ rather than ‘nerds’ dominate eculture. ‘e-enthusiasm’ levels were high, with online consumers preferring shopping and buying on the Internet to a shop. Some 95% of respondents said the net was more convenient and 75% said it was cheaper. ‘Not being pressured to buy’ and ‘taking as much time as you want’ were also considered important.

- Consumers rate online service levels highly despite negative publicity in the media. The Internet was consistently rated better than shops or phone services for a range of fulfilment issues from delayed delivery to unexpected charges.

- The Internet is another channel, not another world, and trust in established brands is the most important factor in choosing a company on the net. The top 10 trusted websites in the UK were:

  1. BBC
  2. Yahoo
  3. Virgin
  4. W H Smith
  5. BT
  6. = Marks and Spencer
  7. = Microsoft
  8. Amazon
  9. Freeserve
  10. Argos

  Clicks and mortar brands are likely to be successful, particularly given the huge difference in the cost of customer acquisition compared with pure-plays. However, a small but select number of ‘web brands’ are joining the ranks of high street brands.

- Digital TV and other devices rather than the PC will dominate in the future. The Henley Centre forecasts that, by 2009, 80% of British consumers will be using Interactive services (mobile phones, digital TV or Internet appliances) but from 2003 onwards Internet penetration will exceed PC penetration. Interactivity will therefore be a mass market phenomenon for UK consumers before the end of the decade: businesses will have to decide on the right balance across a variety of channels.
Consumers are ‘modal’ and want multi-demand choice. The Henley Centre believes that the same person can vary their behaviour at different times of the day or week and therefore be more variable than two different types of consumers, depending on what role/mode they are in. For example someone may get their account balance online or if they’re near a branch go in and ask for it. Modality makes prediction difficult but Henley’s research also shows that consumers want telephone back-up (just in case) when they’re buying on the web. The desire for variety is also strong and people prefer choice.

The Henley Centre’s view of interactive TV is supported by other data. In the UK some 41% of households have a home PC and 31% of these use the Internet. Nearly 100% of households have access to at least one TV. The metrics therefore suggest TV could generate a high degree of online potential (see Figure 2.3).

The main difference between interactive TV and ordinary TV shopping channels is the ‘buy’ button. Open (Sky’s digital interactive shopping channel) was launched in 1999 and extended existing TV shopping channels. NTL, Telewest and Cable and Wireless are all developing interactive shopping channels.

Currently 4.5 million households in the UK have digital TV (DTV) and this is expected by Verdict to grow to 15.2 million in 2005. The current switch-off target for analogue TV is 2010, which was set by the UK government in 1999. However, with current rates of TV growth it will probably be necessary for the government to subsidise purchase if all households are to have DTV access by 2010.

According to research by Oftel (2000), over 60% of UK digital TV consumers have interactive services such as home shopping, banking or information services, and 34% have email / Internet services. Some 18% of these had used online shopping services although the frequency of use was relatively low (30% used it more than once a month but the majority used it less frequently). The majority of users also found the level of service good, and 43% of non-users were interested in DTV for future online shopping. Current digital growth is driven solely by existing analogue pay TV subscribers switching to digital services. About one third of digital customers are new customers and Oftel expect usage to continue to expand as consumer confidence grows.

TV is a familiar and safe technology with which most people feel comfortable and BT’s ADSL is set to speed up Internet access. DTV providers are creating ‘walled gardens’ for users, populated by high street branded retailers. The emphasis is therefore built on a ‘mall-based’ approach.

Verdict (2000) also suggest that by 2005 one third of online sales will be through digital TV. However there are potential barriers to this:

- Only a limited number of people have access to cable (only 50% of UK households with 25% currently connected).
- Retailers will have to incur the costs of maintaining a channel presence (through a rental payment to service providers).
- A variety of platforms are likely to be available which may lead to customer confusion.
In the future, Bluetooth is also likely to make an impact. This is a short range wireless technology which is designed to replace the wires that connect devices such as PCs, digital cameras, printers, mobile phones, and other gadgets. Developed by Intel, Toshiba, IBM, 3Com, Motorola, Ericsson, Nokia, Lucent and Microsoft, the first Bluetooth enabled devices are likely to reach consumers in mid 2001. Future roles may include:

- Bluetooth-enabled credit cards to pay in shops without even going to the cash desk; and,
- The ‘networked home’ with entertainment, communications, security and home automation all linked internally via wireless technology and externally through a home gateway to the Web.

3.7 Summary
At the beginning of 2000 many felt that dot.com companies still had a bright future. At the end of 2000 the landscape of ecommerce shows a very different picture. With high cash burn rates and corrections in overpricing in the markets, many face an uncertain future. The weight of opinion is now probably very much in favour of a multichannel future and one which pure-plays will find increasingly competitive, not least from their bricks and mortar counterparts.

Although futurists have suggested that touch and feel may be replicated online at some point, ‘touchy feely’ goods are likely to be less under threat from the Internet and ecommerce than less tangible or repeat purchase items. Despite this, the threat of the Internet to some conventional store-based retailers is very real. A reduction of 15% in trade could plunge some stores into a loss-making position and our analysis of some famous high street names shows that at low margins even losses of over 5% in turnover could prove hazardous.

Those store-based retailers who have grasped the ecommerce nettle have adopted a range of strategies. Some have used the Internet very much as an ‘information-only’ add-on, whereas others have combined both an online and physical stores approach in a ‘multichannel’ model. Research suggests that major issues for any retailer with an online capability remains customer fulfilment and delivery, as well as easing consumers’ continuing fears over security.
Key Points

Key Trends in Retail Property

- There is evidence of a shift from the ‘old economy to the ‘new economy’. As a result, corporate and occupier retail real estate needs and requirements are also shifting. However, real estate is still in demand by legacy and pure-play and multichannel retailers.

- The growth of the Internet and its role as a driver for corporate change comes at a time when many organisations are considering real estate divestment for other reasons. For example, returns on real estate are frequently below what could be earned by the same capital being redeployed in the business. In the UK, accounting changes such as SSAP 21 will also form an important role in the decision as to whether to ‘divest’ or ‘spin-off’ real estate, perhaps through securitisation.

- In space terms, although UK ‘high street’ shopping has declined from 1980-99, this has been more than offset by the growth of town centre shopping malls. Consolidation of space continues and although the high street is still important it faces stiff competition from out-of-town locations as its relative share of total sales declines.

- UK retail property (particularly shopping centres) has traditionally performed well as an investment sector, and this has been reflected in institutions increasing their holdings in retail over the 1990s. More recently, during 2000 retail has performed more sluggishly than other sectors, prompting views in some quarters of an imminent topping out of the market.

- Theoretically, the economics of the Internet favours ‘pure-plays’ in terms of ‘scalability’ and lower real estate costs. In reality, distribution and fulfilment is an important issue, and initial costs, particularly on advertising and fixed costs, tend to spiral upwards in the early days of Internet start-up.

The Case of Banks and Building Societies

- UK financial services have already been hit hard by the impact of the Internet. Historically, as new technology has pervaded this sector so the number of UK banks and building society branches has declined. In an Internet future other services such as travel will come under threat.

The Future Impact of Ecommerce on Retail Property

- Paradoxically, US research has suggested that etailers do not necessarily carry a real estate cost advantage over conventional retailers in the early days of start-up. There is also evidence (from a recent Arthur Andersen/Rosen US study (2000)) that retailers with ebusiness capabilities are expanding their physical, real estate presence at above average rates for the retail sector. Retailers without an online presence are closing stores at a faster rate than those with an online presence. Various ‘scenario studies’ have been carried out in the UK and focus on the retail sector. Key themes to emerge from these studies include: a growing polarisation between prime and secondary retail space, but a
4.1 Key Trends in retail property

The retail sector employs 10% of the working population in the UK and retail sales currently account for 24% of GDP by expenditure. By the same token retail property accounts for 50% by value of institutionally held property investments. The rapid growth in ecommerce raises important questions for both retailers and investors/developers in retail property. Not only that, but the focus on ecommerce comes at a time when retail property itself faces other parallel trends and shifts.

4.1.1 Corporate retail property

Some suggest the Internet is part of the growth of the ‘New Economy’. The Armageddonists argue that physical assets are ‘deadweight’ and that, in the rapid transition to a knowledge economy, physical assets can actually hinder progress.

This may be an extreme view but the ‘New Economy’ (which Wired magazine referred to as the combination of globalisation, market deregulation, and proliferating information technology which has created a new, high growth, high productivity economy) has spawned a new retail economy.

The changing characteristics of the ‘old’ and new economies are shown in Table 4.1. These arguments are reinforced by some who believe that legacy retailers cannot necessarily adapt their sales channels and may suffer ‘channel conflict’ (a new Internet sales channel which breaks into an existing store-based channel) and ‘cannibalisation’ of existing sales from stores.

Although retailers are in the principal business of selling goods to consumers, they own (or lease) many thousands of buildings, and valuable land. Moreover, some retailers, such as Boots, Kingfisher, Dixon Group and Burton Group (now Arcadia), also set up separate property development subsidiaries during the late

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**Table 4.1 The old retail economy and the new**

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>OLD ECONOMY</th>
<th>NEW ECONOMY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisation</td>
<td>Hierarchical</td>
<td>Networked</td>
</tr>
<tr>
<td>Systems Mindset</td>
<td>Closed</td>
<td>Open</td>
</tr>
<tr>
<td>Industry Structure</td>
<td>Consolidated</td>
<td>Demassified</td>
</tr>
<tr>
<td>Marketing</td>
<td>Mass</td>
<td>Interactive</td>
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<tr>
<td>Assets</td>
<td>Tangible</td>
<td>Intangible</td>
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<tr>
<td></td>
<td>Inventory</td>
<td>Information</td>
</tr>
<tr>
<td></td>
<td>Real Estate</td>
<td>Relationships</td>
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<tr>
<td>Capital</td>
<td>Financial</td>
<td>Knowledge</td>
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<tr>
<td>Pricing</td>
<td>Inflation</td>
<td>Deflation</td>
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<tr>
<td>Economic Model</td>
<td>Productivity Loop</td>
<td>Value Chain Management</td>
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<tr>
<td>Management</td>
<td>Control</td>
<td>Collaboration</td>
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<tr>
<td>Merchandising</td>
<td>Buy It Right</td>
<td>Customer Directed</td>
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<tr>
<td>Real Estate</td>
<td>Development</td>
<td>Redevelopment</td>
</tr>
</tbody>
</table>

After PricewaterhouseCoopers, 1999
THE IMPACT OF ONLINE SHOPPING ON UK RETAIL PROPERTY

Table 4.2 Proportions of property owned as freehold 1994-1999 (net book values)

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>FREEHOLD AS % OF ALL PROPERTY</th>
<th>% CHANGE</th>
<th>PROPERTY AS % OF TOTAL FIXED ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1994</td>
<td>1999</td>
<td>1999</td>
</tr>
<tr>
<td>Wm Morrison</td>
<td>90.4</td>
<td>92.9(1)</td>
<td>+2.8</td>
</tr>
<tr>
<td>W H Smith</td>
<td>90.3</td>
<td>27.7</td>
<td>-69.3</td>
</tr>
<tr>
<td>J Sainsbury</td>
<td>85.6</td>
<td>75.9</td>
<td>-11.3</td>
</tr>
<tr>
<td>Tesco</td>
<td>85.2</td>
<td>85.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>Great Universal Stores</td>
<td>83.7</td>
<td>75.0</td>
<td>-10.4</td>
</tr>
<tr>
<td>Boots</td>
<td>82.1</td>
<td>77.9</td>
<td>-5.1</td>
</tr>
<tr>
<td>Sears(2)</td>
<td>81.7</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Argyll Group/Safeway</td>
<td>81.1</td>
<td>87.9</td>
<td>+8.4</td>
</tr>
<tr>
<td>Kwik Save(3)</td>
<td>77.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Kingfisher</td>
<td>73.9</td>
<td>81.9</td>
<td>+10.8</td>
</tr>
<tr>
<td>Iceland</td>
<td>69.2</td>
<td>69.9(1)</td>
<td>+1.1</td>
</tr>
<tr>
<td>MFI</td>
<td>62.7</td>
<td>71.9</td>
<td>+14.7</td>
</tr>
<tr>
<td>Marks &amp; Spencer</td>
<td>59.5</td>
<td>70.1</td>
<td>+17.8</td>
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<tr>
<td>Asda Group(4)</td>
<td>57.3</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>John Lewis</td>
<td>57.0</td>
<td>61.7</td>
<td>+8.2</td>
</tr>
<tr>
<td>Burton Group/Arcadia</td>
<td>38.9</td>
<td>18.8</td>
<td>-51.7</td>
</tr>
<tr>
<td>Isosceles(5)</td>
<td>34.9</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Storehouse</td>
<td>26.3</td>
<td>19.4</td>
<td>-26.2</td>
</tr>
</tbody>
</table>

Sources: Guy (1997); company accounts

All property valuations based on net book value

Notes
(1) 2000 figures
(2) All Sears womenswear chains acquired by Arcadia in 1998
(3) Kwik Save merged with Somerfield plc in 1998
(4) ASDA acquired by Wal-Mart in 1999
(5) Isosceles dissolved following demerger of Gateway and Somerfield in 1996

1980s and initiated development of shopping centres and other schemes. Real estate is therefore certainly a vital element in corporate financial statements. In the US Nelson et al (1999) suggested that when buildings were inflation adjusted real estate represented about 40% of corporate assets. This figure ties in with Currie and Scott’s (1991) UK study which finds that property represents approximately 150% of net assets, 30-40% of total assets and 100% of capital in the balance sheets of companies.

Our own analysis of corporate real estate holdings for UK retailers builds on earlier work by Guy (1997). Table 4.2 shows how the property holdings of a sample of UK retailers has changed over a five year period. The proportions are based on the net book value as quoted in the annual accounts.

Over the five years the mean percentage of freehold property of the sample fell from 68.7% to 65.4%. However, the degree of variability has increased.

The high levels of property ownership amongst retailers reflects the need for sale, storage and distribution but also the high value of retail property. Indeed, property assets are often used by retailers as collateral for corporate debt in order to finance trading growth.

Various measures have been used to determine the importance of real estate assets within corporate balance sheets – these include:

- ‘property asset intensity’ (Liow, 1995): the proportion of total tangible assets represented by property in a company’s asset structure; and
- ‘real estate concentration’ (Deng & Gyourko, 1999): the proportion of total assets represented by property, plant and equipment (including buildings at cost plus land plus improvements). Both are at book value.

Nelson et al (1999) used a variety of measures, including a simple, historic cost of total real estate (buildings, land and construction in progress) to total assets. They also used measures which incorporated an inflation adjustment for the buildings component.

More recently, Sclauch and Laposa (2000) compared the real estate strategies of retailers (i.e. those conducting their business operations solely on the Internet) and traditional retailers (i.e. who may also have an online presence). Using a combination of qualitative and
Sclauh and Laposa also tested the degree to which etailers had greater space efficiency than retailers in the USA. Using both rental expenses data and sales and administrative cost data as a percentage of sales produced some surprising findings.

In particular, both rental and sales and administrative expense ratios were higher for etailers than retailers. This may be due to the relative immaturity of the sector, reflecting high initial costs, and this is supported by the fact that ratios have fallen for Amazon, a more mature etailer, over time. Within the etail group, ratios were lower for the portals than the distributors. They also found that some retailers were rapidly expanding their real estate holdings. This all seems to suggest from their limited evidence that US etailers are not yet realising the benefits of their non-retail, online operations.

There is also other evidence to suggest that real estate is still very much part of the business, whether online or store-based. In a recent US survey (Stores and Ernst and Young, 2000), 85% of retailers (both ‘legacy’ and ‘pure-play’) indicated that online growth had impacted on their real estate strategy and holdings. Pure-play companies underestimated the need for physical space when doing business in the virtual world. More than half of the companies interviewed had expanded their warehouse/distribution facilities since going online. Also, more than 50% had expanded their office space for customer service and back-office functions. The survey also showed that many clicks and mortar retailers are using their retail locations to help drive online sales (examples include in-store kiosks and personal ‘online shoppers’).

### 4.1.2 Changing accounting standards

Whilst it is true that the Internet and ecommerce are driving the growth of the new economy, other developments in corporate culture and accounting regimes are also challenging the continued role of property on retailers’ balance sheets. Today, therefore, companies are asking what economic return a company can earn if the capital used in real estate is redeployed to the core business. The recent publicity regarding Co-op Schweiz in Switzerland, and J Sainsbury and Marks and Spencer in the UK and their consideration of real estate divestments shows that retailers are taking such options seriously.

More recently, the property industry in the UK awaits the outcome of the Accounting Standards Board (ASB) discussion paper on the accounting treatment of leases. Currently, accounting standards in the UK identify ‘finance leases’ and ‘operating leases’ (the latter includes estate leases) and treats them differently (SSAP21). Some conflicts exist between SSAP21 and FRS5 (‘Reporting the substance of transactions’), in that the latter does not recognise the distinction between operating and finance leases.

This implies all future lease obligations should be capitalised on the balance sheet. The assets and liabilities of property leases, for example, are not reflected in the balance sheet, with implications for debt levels, gearing ratios, return on assets employed and interest cover. In its quantitative analysis based on EDGAR/SEC returns, they classified US etailers and retailers as shown in Table 4.3.

<table>
<thead>
<tr>
<th>ETAILERS</th>
<th>CHARACTERISTICS</th>
<th>US EXAMPLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portals</td>
<td>Products shipped directly from third party</td>
<td>CD Now</td>
</tr>
<tr>
<td>Distributors</td>
<td>Products shipped direct from own warehouse</td>
<td>Amazon</td>
</tr>
<tr>
<td>Mixed</td>
<td>Combination of third party and own facilities</td>
<td>Reel.com</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>RETAILERS</th>
<th>CHARACTERISTICS</th>
<th>US EXAMPLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Focused</td>
<td>Continuing as legacy player</td>
<td>Barnes and Noble</td>
</tr>
<tr>
<td>Mixed Media</td>
<td>Combining bricks and clicks</td>
<td>Gap</td>
</tr>
</tbody>
</table>
recommendations the ASB therefore suggest that accounts should reflect the fair value of the rights and obligations enjoyed by the lease, as measured by present values of the minimum payments required, with commensurate impacts on the reported liabilities and profit and loss accounts. The ramifications could include:

- higher gearing for companies holding operating leases;
- a move away from sale and leaseback toward freehold ownership; and,
- a trend toward shorter leases and perhaps higher rents and higher yields, particularly in the retail sector.

4.1.3 Changing retail property floorspace patterns

The threat of ecommerce in the high street comes at a time when the retail floorspace landscape has changed dramatically and when investors are posing serious questions about retail property performance.

The key trends that were highlighted earlier in this report have certainly impacted on floorspace patterns in the UK. The retail landscape of 2000 in the UK is very different from the one of 20 years ago. Changes in lifestyle, cycles in economic growth, a tightening of the planning regime (through PPG6 and PPG13), and the recent store closures of leading retailers have all combined to create a changed landscape.

Consolidation in the retail sector has also reduced the number of stores but increased store size. This also reflects the decline in neighbourhood stores versus out-of-town superstores (Figure 4.1).

Overall retail floorspace has increased from 38.8m square metres (418m square feet) in 1980 to currently some 60m square metres (646m square feet) of mainstream retail stock in the UK (which includes high street stock, managed shopping centre malls, district and neighbourhood centres, retail parks, superstores and factory outlets). This represents an increase of 1m square metres (10.8m square feet) per annum over almost 20 years.

However, this masks a marginal fall in the high street share of floorspace over the same period with nearly 28m square metres (300m square feet) in 1980 (75% of total space) to 27m square metres (290m square feet) in 1998 (45% of total space). As Figure 4.1 shows, falling sales densities and the competition from out-of-town has led to a decline in relative sales share from 54% in 1990 to 49% in 2000.

Despite this, the growth of town centre shopping malls has more than made up for this erosion of town centre trading. Managed shopping malls in-town centres totalled 6.5m square metres (70m square feet) in 1980: today they total 10.55m square metres (a rise of more than

---

**Figure 4.1 UK Retail Floorspace Changes**

There is an increasing consolidation of retail space...

Although the high street is still important...

...it faces stiff competition from out-of-town locations...

...as its relative share of total sales declines

Note: Data based on DTZ (2000) and Verdict (2000)
As a result, 18% of all retail space in the UK is found in shopping malls located in-town centres. In turn this represents a rise of 9% from 35m square metres (377m square feet) in 1980 to 38m square metres (409m square feet) today.

Taken together with new shopping centres that use space more efficiently, these figures show that the so-called ‘decline’ of the town centres needs careful scrutiny.

Nevertheless, the boom in out-of-town centres does put this growth into perspective. In 1980 only 1.08m square metres (11.6m square feet) of out-of-town centres existed. Since then this has grown to 4.6m square metres (49.5m square feet), 7.7% of retail stock, supported by growth in out-of-town centres, regional malls, district centres and factory outlet centres.

DTZ (1999) suggest that, in 2000, on the basis of retail sales, expected trends in sales productivity and retail sales in the pipeline, the high street (as a whole) will still account for 46% of retail space with a further 18% taken up by in-town centres. This will occur despite a fall in traditional high street space between 1998 and 2000.

Polarisation between prime and secondary locations is likely to continue as the planning regime bites. At a town level, for example, in the 1960s, 50% of non-food sales came from the largest 200 locations; in 1997 the same 50% came from just 80 locations. Verdict estimate that the top 100 high street locations account for 58% of non-food spending.

Most commentators also now believe the White City regional shopping centre will be the last of its kind, thus reinforcing restructured supply trends (i.e. new retail completions in 1998-2000 are likely to be around 50% of the rate recorded over the last 18 years).

The decision by C & A to quit trading in the UK, together with Arcadia’s and Marks & Spencer’s decisions to reduce the number of stores, may result in an oversupply of space. C & A alone is expected to release about 140,000 square metres (1.5m square feet) of selling space towards the end of the year and into 2001.

### 4.1.4 A slowdown in retail property investment performance

Recent doubts have been expressed about retail’s ability to maintain long term performance, given continuing falls in consumer expenditure. However, historic data shows a rosier picture.

For example, data from Investment Property Databank (1999) suggests that over the period 1980-98 retail, office and industrial have all shared the same broad cycle but with some points of difference in amplitude. Retail and industrials have produced very similar rates of return, despite large differences in rates of rental value growth. Within retail, retail warehouses have performed strongly over the cycle. More recently, shopping centres were the best performing retail segment in 1999 with total returns of 15.1%. Returns on retail warehouses and standard shops were 14.8% and 12.5% respectively. Given uniform rental growth across the three types of 5.6-5.8%, the critical factor was movements in yields. Shopping centres benefited from a relatively large decline in equivalent yields of 0.4 points, whereas shop yields were virtually static.

Institutional investor sentiment has, however, switched in favour of retail over the last two decades. In the early 1980s only 28-30% of institutional property investment portfolios were invested in retail property. By the late 1990s this had increased to around 44%, reflecting the performance of retail property during this period.
More recently, during 2000 retail property tended to perform much more sluggishly than other sectors, with returns running at less than half those in offices or industrial sectors. Rental growth, for example, weakened from 5.8% in the year to December 1999 to 4.8% in the year to June 2000. Average retail rents (IPD monthly index) have also shown weaker rental growth recently: for the 6 months to August 2000, retail properties produced total returns less than half of those on offices/industrial real estate.

Trading conditions and price deflation on the high street have already made an impact, with Arcadia and Marks & Spencer announcing store closures, and C & A set to withdraw from the UK entirely. Ultimately, if rents continue to outpace sales growth, retailers will face a squeeze on margins, which may be exacerbated further by sales leakage to online channels.

4.1.5 Changing lease lengths, but weakening sales demand and higher rents

The preference for shorter, more flexible leases has been aired powerfully by retailers who want to maintain rapid response strategies to deal with the greater uncertainty of increased competition and consumer-centric markets.

Evidence suggests that there has been some movement. At the beginning of the 1990s, the typical ‘institutional’ lease was usually on FRI terms for a term of 20 or 25 years with 5 yearly reviews and upwards only rent reviews. At the end of the 1990s (DETR, 2000) the longest leases are found in the institutional market with the shortest leases granted to local occupiers in smaller, less valuable, properties. Size and value of letting are more important than region or town type in determining lease length. Although market value based upwards only rent reviews are still the main form of rent review, there is some evidence of decline in use, alongside an increasing use of tenant’s break clauses and some evidence of the transfer of repairing liabilities towards landlords.

The same research has also shown an inexorable decline in lease length over the same period. In 1990 the average retail lease was 23 years (weighted by rent and based on IPD data). On an unweighted basis (i.e. by number of leases) it was 20.1 years. This also suggests a two tier market with larger lettings held on long leases but smaller lettings on shorter leases and auction, and Valuation Office Agency data in the same research also support this finding.

However, by 1998 the average weighted lease length for retail was 15.4 years (unweighted, 9.3 years). Similar declines also occurred in other sectors of the market. This suggests that tenants have been able to negotiate shorter leases during the early 1990s as a result of the recession during that time, although the research also found that average lease lengths in 1998 were
similar to those in 1995, which suggests the trend towards shorter leases has stabilised.

Finally, within retail, the IPD data shows some interesting patterns: although shopping centre leases and standard retail units have declined in terms of lease length, retail warehouse leases have remained at relatively high figures, the latter perhaps reflecting the lower demand for flexibility in such property (Figure 4.3).

Set against this, however, retailers have had to cope with falling sales and rising rents on upwards only rent reviews. For example, from 1993-99 retail sales increased by 20% but rents by 30% (Figure 4.3)

Pressures on the margins of retailers who are tied into upwards only rent reviews have led to calls for the introduction of turnover leases. Turnover (or ‘percentage leases’) have been common since the 1930s in the USA where they emerged as a result of letting problems by retail developers during the depression.

In the UK, turnover leases in retail were relatively rare until the 1970s. Since then some property companies have implemented turnover leases in new retail developments. Turnover rents are believed by many to promote more active management by landlords because, for example, the maximisation of tenant income is promoted. Against this, others have argued that the accuracy of sales reporting by tenants is questionable and that financial institutions may be wary of lending on such schemes, because of the lack of certainty of income.

In the UK the percentage is usually based on net turnover after deducting such items as VAT, sales to staff, returns. In addition the percentage is usually fixed for the term of the lease although variations may occur depending on changes of use and occupier.

In the UK three main types of agreement can be identified:

- pure turnover (rent is a percentage of turnover);
- base rent plus turnover (e.g. 80% of ERV for base rent plus a percentage of turnover, say 1-2% for supermarkets and clothes shops/restaurants, 10%);
- base rent or turnover related income (i.e. a fixed based rent as a percentage of turnover or percentage of turnover, whichever is higher).

Data from IPD and the DETR (2000) shows that in 1998 less than 4% of shopping centre units were on turnover.

Finally, additional pressures have come from increased rates as a result of the revaluation in April 2000.

In summary, although property still seems to be a fundamental part of the retailer’s business, the Internet is placing the role of the physical store under threat. Retailers face a dual dilemma: should they continue to hold retail space and how should they grasp the ecommerce nettle?
4.2 The future impact of ecommerce on retail property

4.2.1 UK studies

At the time of writing there has been little or no empirical work published in the UK on how precisely ecommerce will impact on real estate values. Indeed, what material has been produced by the major surveying practices arrives at varying views of the impact of ecommerce, particularly on the high street:

‘…whilst the innovative home shopping sector will undoubtedly continue to grow, providing the UK consumer with a wide range of ways to shop, these are likely to be complementary to high street shopping rather than a replacement for the high street shop. It is therefore unlikely that home shopping will have a significant impact on retailers’ requirements for high street floorspace in the short to medium term’. Knight Frank (1999)

‘Retailing technology is likely to have a significant impact on how we shop in the 21st Century…however…e-commerce… will challenge the high street, not decimate it. It will affect the type of retailers represented on the high street and the services they offer their customers. Institutions and retailers should be aware of the potential impact this will have on the retail market from a property perspective’. Knight Frank (2000)

‘E-commerce currently accounts for only 0.2% of retail sales within the UK but its growth within the next 10 years will, in our opinion, transform the high street’. Colliers Erdman Lewis (1999)

‘In the short term little will change, but there will be winners and losers as a result of ecommerce. E-commerce is not just a fad and it will ultimately have a considerable impact on the way business is transacted and therefore on the way occupiers utilise their property…[but] to write the obituary of the high street would be somewhat premature’. Weatherall Green and Smith (1999)

‘The high street will survive but in a reduced form…e-tailing will remain one of the many retail channels of distribution and will not replace the high street’. Chesterton (2000)

There has, however, been a flourishing production of ‘futures research’, using scenario planning techniques. Proponents of scenario planning (see Box 5) argue that it provides a way of...
<table>
<thead>
<tr>
<th>Table 4.4 Scenarios of Retail Futures</th>
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<tbody>
<tr>
<td><strong>POLITICAL AND TRENDS</strong></td>
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<tr>
<td><strong>RICS RESEARCH FOUNDATION – 20:20 VISION</strong></td>
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<tr>
<td><strong>Wired wonderland</strong></td>
</tr>
<tr>
<td><strong>Social security</strong></td>
</tr>
<tr>
<td><strong>JONES LANG LASALLE – RETAIL 2010</strong></td>
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<tr>
<td><strong>New Lifestyles, New Rules</strong></td>
</tr>
<tr>
<td><strong>RETAIL ECOMMERCE TASK FORCE – CLICKS AND MORTAR</strong></td>
</tr>
<tr>
<td><strong>Explosive</strong></td>
</tr>
<tr>
<td><strong>Dynamic</strong></td>
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<tr>
<td><strong>Active</strong></td>
</tr>
<tr>
<td><strong>Sluggish</strong></td>
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</table>
identifying timelines to possible outcomes without being tied to forecasts or predictions. Some recent examples of the use of this technique are (Table 4.4):

- Jones Lang LaSalle (2000): ‘Retail Futures’; and

The DTI/BRC/Foresight (1999) study arrived at three scenarios:

- ‘Sustainable development’ scenario, where town centres are revitalised through urban regeneration, but where environmental legislation leads to higher prices and congestion from home delivery;
- ‘Internationalisation of UK and domestic markets’, where the scenario suggests lower prices but UK dominated by international retailers;
- ‘Small and smart’ scenario, where small retailers using smart technology outperform large retailers with IT and virtual presence resulting in a backlash against big business.

This was extended with a more recent report which took four scenarios: ‘Explosive’, ‘Dynamic’, ‘Active’ and ‘Sluggish’.

Sparks and Findlay (op cit) built on this and work by Scase (1999) to suggest that the two key drivers for change are the role and impact of technology and the danger of inequality. In turn they suggest three different scenarios:

- ‘Wired wonderland’, where the e-tail future is fully embraced and socio-economic tensions are resolved;
- ‘Social security’, a ‘middle path’ scenario, where balance is achieved between social and economic futures, and where technology is important, but not dominant; and
- ‘Compound calamity’, in which tensions in society and economy have forced massive divisions between the ‘haves’ and ‘have nots’.

Were any scenario or combination of scenarios to become a reality, Sparks and Findlay argue that the future of shopping and retailing may be impacted in a variety of ways, which include:

- Retailers will be bigger companies with targeted formats (and may be based overseas);
- Local retailers will be important as will the service and leisure component of shops;
- E-tailing will lead to some replacement of existing retailing at the mundane (or ‘convenience’) end of the spectrum;
- Environments will be enhanced and rebuilt regularly;
- The needs of the older consumer will be important.

Jones Lang LaSalle (op cit) drew on a database of 1 million interviews with consumers across Europe to produce three scenarios. Overlaid on their scenarios are four pre-conceptions (or drivers) which are likely to remain important for the next 10-15 years. These are:

- The continuing growth of globalisation and new technology;
- The continuing integration of the EU;
Changing consumer lifestyles particularly the power of the ‘grey pound’ as the population ages;

The way people shop: the typology of shopping will continue in its present shape (i.e. ‘household/personal management’, ‘morale boosting’, ‘top-up and leisure’).

Three scenarios were then constructed:

‘Fresh air and free markets’, where the current brand of post-Thatcherite capitalism spreads to Europe;

‘Stakeholder’ scenario, where the current continental, social-democratic model spreads to the UK; and

‘New lifestyle, New Rules’ scenario, where a new age blend of 1960’s values and Californian social fluency becomes vogue.

As with other ‘future studies’ the JLL study is characterised by a ‘top-down’ approach but is somewhat more incisive about the potential and specific impact on property. Nonetheless, it hedges its bets by stressing that the extent to which each is realised is ‘scenario dependent’. These are shown in summary in Figure 4.4. Furthermore, JLL suggest that certain retail sectors will be ‘winners’ and others ‘losers’ (Table 4.5).

This tends to suggest that an increasing polarisation between prime and secondary locations will occur as the impact of the Internet is felt by retailers. This point has been raised by DTZ (1999) and by ABN-AMRO (1999). The latter suggests that falling footfall and conversion rates in the high street will shift real estate requirements away from retail towards warehousing. As secondary locations are already in decline this is likely to reinforce this effect. Centres offering comparison shopping with a shopping experience are likely to flourish, however.

More recently, Doidge and Higgins (2000) have produced an empirical study which concludes that e-tailing will have little impact on existing shopping floorspace although its effects are likely to be uneven. In marked contrast to their 1999 report they suggest:

‘The potential impact on retailing has been over-hyped and misguided. We believe the high street will continue to survive (and perhaps even prosper) while it is the out-of-town retail
Our findings are bearish...

Questioning the fundamentals of etail sales growth, they point out that the online market share would need to increase twelve-fold from 2000-2004 to fulfil even a 3.5% share of retail sales in 2004. Their survey of shoppers also indicates that online suits only certain categories of goods: for example, only 1.2% of households in their sample had bought clothing or footwear on the Web.

In terms of the impact on the high street they suggest only 11% of space is at risk (in the CDs, books and other online ‘winners’ categories) whereas 24% of out-of-town space is at risk (see Table 4.6).

De Kare-Silver (2000) suggests that when people go shopping in the future the focus will be on experiencing, seeing and trying new products and services rather than doing the weekly shop. This is based on the premise that basic groceries and other regularly purchased items can be delivered to homes and those which have a high primary appeal to the virtual senses can be ordered through the PC or TV (e.g. books, music, computer software/hardware, banking services).

Retailers have already added services such as banking, pharmacies, coffee shops and restaurants to the range of services they offer. Shopping malls are also increasing the whole experience of shopping as an entertainment. As these trends continue and high street trade falls at the expense of out-of-town centres, De Kare-Silver (op cit) sees a polarisation of retail shopping taking pace. Larger centres will grow in attraction and smaller centres will begin to suffer. The resultant shopping environment is shown in Figure 4.5.

Retail Intelligence (2000) see the home shopping market as having only limited impact, however. Taking the view that it will not lead to the death of the high street they argue that ecommerce is not a short cut to retail success: the skills needed are very different. Moreover, because ‘people like shopping’ and because of the high advertising costs needed by online retailers, online price is unlikely to be competitive. The recent history of mail order catalogues and their relationship with traditional channels gives some support to this view, they suggest. It is, however, likely that smaller shopping centres and some supermarkets are at risk.

<table>
<thead>
<tr>
<th>Table 4.6 Impact of etailing: key pressure points</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH STREET CHARACTERISTICS</td>
</tr>
<tr>
<td>11% of non-food floorspace is vulnerable</td>
</tr>
<tr>
<td>Small overlap with Internet goods sectors-anchored mainly in ‘touch-and-try’ goods</td>
</tr>
<tr>
<td>Provides a value-added shopping experience</td>
</tr>
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<table>
<thead>
<tr>
<th>IMPLICATIONS FOR THE HIGH STREET</th>
<th>IMPLICATIONS FOR OUT-OF-TOWN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best outlook for either large or small centres</td>
<td>Fashion parks are well-placed</td>
</tr>
<tr>
<td>Medium-sized centres which do not offer a shopping/leisure experience may be most vulnerable to etailing</td>
<td>Sheds trading in electronic winners are vulnerable</td>
</tr>
<tr>
<td>Opportunities for re-use as etail storage/distribution/pick-up facilities</td>
<td></td>
</tr>
</tbody>
</table>

Source: Doidge and Higgins (2000)
However, we have already seen the decline in the number of banks and building societies and this is likely to increase in the financial and travel service sectors. The next section examines this phenomenon in more detail.

4.2.2 The case of UK banks and building societies

Over recent years there have been a series of major and sometimes well publicised bank branch closures. Of all the main high-street occupiers, financial services have reduced their branch networks substantially. Data from the British Bankers Association indicates that in 1994 there were 13,950 branches run by the ‘major British banking groups’. By December 1999 numbers had fallen by almost 20% to 11,274 branches.

The main drivers to changes in the property requirements of banks have been innovative products and new ways of banking that take place outside a traditional bank branch. October 1989 is often seen as a watershed, the time when telephone bankers First Direct appeared on the market (Freeman Publishing, 2000). Indeed it has tended to be real estate that has created an oligopoly within the UK banking sector (Henderson, 1995). Traditional delivery strategies require a bank to develop an extensive branch network – a major barrier for new entrants. There have been other subsequent developments from the major British banks, including telephone, Internet and interactive TV banking. Increased usage of Automatic Teller Machines (ATMs), have also made some branch functions redundant, and have led to some branches merely housing a collection of ATMs (see Figure 4.6).

In addition to the growing demand for new technologies, there has also been an ongoing process of consolidation throughout the 1990s. Major building societies such as Abbey National, Halifax and Northern Rock have demutualised and converted to banks. Other building societies have been acquired by banks (e.g. National & Provincial, Leeds Permanent, Birmingham Midshires). During the late 1990s, major clearing banks began consolidation activity, with HFSBC absorbing Midland Bank, NatWest being taken over by Royal Bank of Scotland and the Lloyds Bank/TSB merger.

Table 4.7 Branch numbers for selected banks, 1994-99

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<tbody>
<tr>
<td>Abbey National*</td>
<td>999</td>
<td>1004</td>
<td>867</td>
<td>816</td>
<td>791</td>
<td>765</td>
</tr>
<tr>
<td>Barclays</td>
<td>2090</td>
<td>2050</td>
<td>1997</td>
<td>1975</td>
<td>1950</td>
<td>1899</td>
</tr>
<tr>
<td>Halifax†</td>
<td>1254</td>
<td>1203</td>
<td>1086</td>
<td>1012</td>
<td>933</td>
<td>909</td>
</tr>
<tr>
<td>HSBC Bank</td>
<td>1706</td>
<td>1701</td>
<td>1702</td>
<td>1668</td>
<td>1663</td>
<td>1662</td>
</tr>
<tr>
<td>Lloyds TSB‡</td>
<td>2812</td>
<td>2668</td>
<td>2596</td>
<td>2447</td>
<td>2310</td>
<td>2122</td>
</tr>
<tr>
<td>National Westminster</td>
<td>2410</td>
<td>2215</td>
<td>1920</td>
<td>1754</td>
<td>1727</td>
<td>1712</td>
</tr>
<tr>
<td>Royal Bank of Scotland</td>
<td>732</td>
<td>687</td>
<td>665</td>
<td>673</td>
<td>652</td>
<td>648</td>
</tr>
</tbody>
</table>

Notes
* Figures for 1994 and 1995 include branches of the National & Provincial Building Society.
† Figure for 1994 includes branches of the Leeds Permanent Building Society; figures for 1994-1998 include branches of the Birmingham Midshires Building Society.
‡ Figures for 1994-1998 represent the total branches of Lloyds Bank and TSB combined.

Source: British Bankers Association (2000)
Time series data for individual building societies is not as easily available, however: overall sectoral data is available back to 1970 (Figure 4.7). Thirty years ago there were just over 2,000 building society branches in the UK, belonging to 481 societies. Branch numbers steadily increased during the 1970s and 1980s as societies expanded and the sector consolidated. By 1987 there were nearly 7,000 branches across the country, but only 138 societies. Since 1987 branch numbers have declined, driven mainly by some large societies converting to bank status. This in particular accounts for the small drop in the late 1980s when Abbey National converted, and the large drop in 1997 caused by the conversions of Alliance & Leicester, Halifax, Woolwich and Northern Rock.

These changes in the physical presence of financial service providers in recent years have developed alongside wider social and cultural changes. Jayawardhena & Foley (2000) argue that changing work and home environments have led to a change in the use of banks by society. They also argue that customers now have more sophisticated needs than they once did and that customer inertia has reduced. This trend can be seen in bank lending figures, which show that around 30% of mortgage applications are now transfers (Lawson, 2000). Banks have therefore had to adapt, particularly as technology has now enabled new competitors to enter the market without the need to develop an expensive branch network.

Internet banks have the advantage of providing a similar service using efficient delivery systems and providing a 100% geographical coverage. However, the level of service is variable between institutions as shown in Table 4.8.

Uptake for Internet banking has been somewhat slow. Only a small proportion of Internet users have signed up to ebanking services – Jayawardhena & Foley (op cit.) estimate that there were 540,000 users towards the end of 1999, 28% of which were Egg customers. Jayawardhena & Foley cite four reasons why so few are using online banking services:

- Limited number of banks offering the service (although the banks who have the majority share of customers are the most active in this field);
- Limited control features available on Internet services;
- Technical reasons (e.g. lack of suitable platforms on home PCs); and
- Customer inertia – many prefer human contact when banking, even by telephone.

The latter point appears to be very important. Cap Gemini Ernst & Young (2000) report that pure-play Internet banks can only ever have limited success and have realised that they need a physical presence to attract customers and gain their trust. This strategy has been seen in both
North America and Europe, particularly in countries where cash transfers by paper cheques are still important, such as the UK.

This is supported by Datamonitor (2000) in a survey on Internet banking, which showed that only 8.7% of customers use a PC to access their bank accounts and 0.9% use interactive TV. The vast majority still prefer to use traditional methods of contact (Figure 4.9).

### 4.3 US Studies

In the USA, the view that the retail world is a battle between distinct sales channels (i.e., legacy v pure-play) is defunct (International Council of Shopping Centers, 1999). Rather, the various sales channels need to be viewed as separate pillars in the promotional and sales strategy of all retailers.
Despite these innovations, retailers are under threat, and as Borsuk (1998) points out:

‘Infotech [IT] is diminishing location-based selling’s advantages and shifts the balance of negotiating power to the tenants. Merchants will require far shorter lease terms, with multiple options, and expanded early termination rights. Landlords who understand the structural change ahead will accommodate tenants but at a cost. Investor and lender expectations will also undergo a significant change. Infotech’s widening influence requires new techniques for evaluating retail tenants and for finding ways to transfer the risk of owning and leasing retail space’.

IT’s impact on retail space demand takes the shape of Figure 4.10. The first order consequence is that consumers gravitate online for convenience, device and control and so the ‘geocentric’ shopping pattern, based on distance and location, becomes much less important. As a second order consequence of this, retailers decide to lead or follow their customers online, which causes a migration of sales to the Internet, creating a downward shift in individual store performance. Retailers then alter their sales channel matrix and this impacts on leasing strategy. The third order consequence is therefore an impact on rent and property values and lender and investor expectations. Landlords need to evaluate tenants in a different way through a tenant screen that incorporates questions on the retailer’s ability to adopt and use the Internet effectively. Property owners might similarly need to consider the adoptive reuse potential of their premises.

Borsuk suggests that a new set of metaphors is needed to understand the shifting space demand that ecommerce and the Internet is bringing about (see Table 4.9). He refers to this new concept as ‘metaspace’, which synthesises the concepts of space and cyberspace in retailing.

As a consequence of these trends, Borsuk suggests wired leases will become commonplace. The goal of such leases is to provide retailers with sufficient flexibility at an affordable cost to reconfigure the sales channel matrix as the online channel grows. They are designed to capture Internet sales which may be migrating sales from the conventional sales channel. The concept of ‘metaspace’ requires a different view of rent: for example, visitors visiting a retailer’s site in metaspace create sales which in a conventional turnover lease might be ‘lost’. Future leases must find a way of capturing such sales.

This view has also been echoed by Baen (2000) who suggests that ecommerce is causing a leakage of retail sales at traditional retail locations. The effect on retail property values could therefore be dramatic because of diminished trade at malls and the weight of online sales lost from percentage leases.

Miller (2000) has developed these concepts further by stressing that retail property value is now a function of both physical and virtual retail space. The key assumption behind the
traditional rent model in the US ‘percentage lease’ has been that individual store productivity can be measured through sales per occupied space per period of time. This is no longer valid, however, and new measures of productivity must be sought. Miller suggests a model along the following lines:

$$TR_t = \alpha_t + \beta_t + \chi_t$$

where:

- $\alpha = $ base rent (BR) for each period, $t$, plus percentage rent (PR) from direct store sales
- $\beta = $ rent based on direct sales (e.g. new sales in local store database and physical store sales)
- $\chi = $ rent from channelled shopping centre resources (e.g. web hits, or sales from promotional cards).

The $\chi$ factor above therefore is really a direct consequence of Internet sales and forward-thinking landlords and investors must consider how retail contracts may look in the future.

Using forecasts of future sales from the Internet, Miller suggests three scenarios:

- **Extremely modest Internet Impact**: total rents decline by 1.1%
- **Modest Impact**: total rents decline by 4.4%
- **Substantial Impact in the Long Run**: total rents decline by 25%

As a result it is likely that US regional malls will come under particular pressure. Possible results for landlords of this include:

- Changing the percentage formula;
- Working with retailers by using the Internet together;
- An inverse or negative percentage rent lease; and,  
- Increased brand name patronage through the web.

Physical environments and shopping centre entertainment will, meanwhile, continue to improve (Table 4.10). Interestingly, Arthur Andersen/Rosen (2000) take a more relaxed view, suggesting that, as far as malls are concerned, the Internet will not have a substantial impact in the short term, because percentage rents make up less than 10% of shopping centre revenues in the USA.

In the UK, Jones Lang LaSalle have been examining how wired leases might work in practice (Rose & Roberts, 2000). One way of combining on and offline sales is for landlords to set up shopping centre

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**Table 4.10 Evolution of retail contract models**

<table>
<thead>
<tr>
<th>OLD RENTAL DETERMINANT FACTORS</th>
<th>FUTURE RENTAL DETERMINANT FACTORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Sales levels per space occupied per unit of time.</td>
<td>• Direct store sales per space per unit of time.</td>
</tr>
<tr>
<td>• Profit margin of merchandise sold.</td>
<td>• External retail sales as channelled through back room web orders and web-driven marketing delivered from centralised warehouses.</td>
</tr>
<tr>
<td>• Anchor role – degree of consumer attraction.</td>
<td>• Future external sales as generated by consumer profile data captured, especially potential new customers identified.</td>
</tr>
<tr>
<td></td>
<td>• Anchor role – ability to retail store to attract new customers, with emphasis on the neophyte visitor.</td>
</tr>
<tr>
<td></td>
<td>• Anchor role – ability of store to generate consumer traffic that shop at other stores.</td>
</tr>
<tr>
<td></td>
<td>• Profit margin of merchandise sold.</td>
</tr>
</tbody>
</table>

*After Miller, 2000*
portals which display all retailers and shoppers can then buy from the store or the Internet. Tracking Internet sales through multiples would be more problematic however.

Miller concludes (op cit: 181):

‘The Internet is not an immediate threat to the retail property owner’s bottom line, but will pose significant decreases in rental revenues within a few decades unless new rental models and marketing strategies are developed’.

More recently still, an interesting study by Arthur Andersen Rosen (op.cit.) has taken a more sanguine view of the impact on retail real estate at least in the short term. Using a ‘risk rating approach’ they classified retail property on a risk spectrum (Figure 4.11) with ‘power centers’ (trading on price and product and based around books, toys and sporting goods) most prone after discount/outlet stores, where margins are being squeezed.

In the short term they believe ecommerce will have only a ‘gradual’ impact on physical real estate and sales because of:

- Conservatism in shopping habits;
- Limitations in bandwidth technology;
- Distribution problems; and,
- Lack of profitability of etailers.

Low conversion rates among online population: in the USA, top malls get about 2 billion hits each year but 1 in 200 visitors make a purchase.

Beyond about 2005, however, they suggest ecommerce will affect the entire retail spectrum, encouraging a variety of trends, including a retail model bringing lower prices and increased competition, and leading to a 3-5% loss of trade from conventional stores. However, it is also likely that compression of retail margins will be offset in some sectors with B2B efficiencies and better information and management of inventory and access to new markets. Customisation will evolve and overstored and weak sectors will suffer most.

Interestingly, Arthur Andersen/Rosen (op.cit.) have suggested certain paradoxes regarding the real estate requirements of retailers. In particular their analysis in the USA showed:

- Retailers in all sectors with ebusiness capabilities (e.g. Wal-Mart and The Gap) are expanding their physical presence at an above average rate (9.2% net, compared with 5.8% net for the sector as a whole and 2.6% net for retailers without a virtual presence). This suggests that etailers view virtual expansion as complementing physical expansion.
- Retailers without ebusiness capabilities were closing stores at an above average rate (i.e. 3% net, as compared with an average of 2.1% for ebusiness etailers).

### 4.4 Lessons from USA?

#### 4.4.1 Background

Any direct comparison between the USA and the UK and the tendency for the latter to lag the former in e-commerce is wide of the mark. To begin with, the timing of the e-commerce revolution has been very different in the USA where dot.coms had a clear three year run at
establishing themselves. However, in the UK and the rest of Europe, Internet entrepreneurs and traditional company managers ‘discovered’ ecommerce at about the same time as each other. Add in the differences in culture, differential pricing models for Internet access and distinct geographies and you have two very different environments. Such differences are reflected in the size of current markets and Internet access levels, as Table 4.11 shows.

For example, the USA dwarfs the UK in terms of current ecommerce revenues, although GDP measures are less noticeable. Importantly, however, in a country which is seen as the world leader in ecommerce, a recent ICSC forecast produced by the University of Wisconsin suggested that 4.7% of retail sales would be online by 2005, with 5.3% by 2010. This is modest in comparison with some of the forecasts made previously for the USA and UK.

4.4.2 US and UK retailing compared

As the ecommerce landscape differs, so it is also true to say that the US shopping experience and retail industry is very different from our own. This has also been reflected in the relatively rapid growth of web access to shopping centres in the USA (88% of shopping centres have websites compared with 10.5% in the UK), a country where the geographical scale of things is much greater.

In the USA, high growth retail companies in sales and profits fall into four district segments:

- Mass merchandise value juggernauts;
- Category value champions;
- Extreme value traders; and,
- Lifestyle brands (e.g. The Gap).

As in the UK, US companies whose customer propositions and operating cost infrastructures fall in between value and brand are suffering market share decline and profit pressure. There has therefore been an increased polarisation between strong value offerings to consumers on lower operating bases and higher brand, taste and quality on higher operating costs.

Traditional department stores and clothing stores have also lost out during the 1990s in the USA to large-scale discount clothing stores such as T.J. Maxx. The latter type of retailer increased sales by 87% in US from 1989-98 compared with a loss of 4% in sales from traditional women’s ready to wear speciality stores. This means regional shopping centres are under threat. Instead, ‘big box’ retailers are expanding in power centres of up to 93,000 square metres (1 million square feet) built around large-scale formats for a range of goods.

A further trend is towards ‘off-price’ centres, most of which have been converted from failed shopping malls, offering a non-department store mix with leisure and entertainment goods which are cheap and the range diverse.

Developed shopping centres in the USA account for just over 50% of total national retail sales and have remained stable for 5 years. Modernised and new shopping centres are also tak-

Table 4.11 The UK and USA compared

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ecommerce revenue ($bn)</td>
<td>3.6</td>
<td>26.3</td>
</tr>
<tr>
<td>% of Western European ecommerce</td>
<td>19.96</td>
<td>146</td>
</tr>
<tr>
<td>% of Western Europe population</td>
<td>15.49</td>
<td>37.72</td>
</tr>
<tr>
<td>Ecommerce revenue as % GDP</td>
<td>1.26</td>
<td>1.43</td>
</tr>
<tr>
<td>B2B revenue ($bn)</td>
<td>3.08</td>
<td>21.45</td>
</tr>
<tr>
<td>B2C revenue ($bn)</td>
<td>0.52</td>
<td>4.85</td>
</tr>
<tr>
<td>Mobile-commerce revenue ($bn)</td>
<td>0.034</td>
<td>0.157</td>
</tr>
<tr>
<td>% of Western Europe m-commerce</td>
<td>14.33</td>
<td>66</td>
</tr>
<tr>
<td>% of Western Europe B2B</td>
<td>0.0105</td>
<td>0.324</td>
</tr>
</tbody>
</table>
ing trade from older centres and this is characterised by well-designed environments, shifts in the tenant mix balance and a trend towards leisure and recreation.

In the UK similar trends may be emerging. For example,

- 30% of sales already take place out-of-town;
- substantial growth of discount retailing allied with family entertainment;
- squeeze of middle market retailers (Peacocks, New Look and Matalan are doing well at the expense of Marks & Spencer and others);
- clothing moving out-of-town: most grocery stores do not need planning consent to sell clothing and so clothing sales are being lost to these stores.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>US retailers cost base is lower (minimum wage costs)</td>
<td>5.15%</td>
<td>5.75%</td>
</tr>
<tr>
<td>Overcapacity in US retail (store rental costs)</td>
<td>$28 per sq ft</td>
<td>$62 per sq ft</td>
</tr>
<tr>
<td>US retailers are larger (combined turnover Top 5 1997)</td>
<td>$126691 mn</td>
<td>$6544 mn</td>
</tr>
<tr>
<td>US has more shopping space per capita (1997)</td>
<td>19.4 sq ft per capita</td>
<td>2.5 sq ft per capita</td>
</tr>
</tbody>
</table>

Nonetheless there are important differences in the retail sectors in the US and UK as Table 4.12 shows. These combine to generate lower prices for US consumers. Significantly data also shows that generally prices are cheaper in US but the amount bought is higher than the UK. This leads to cut-throat pricing with consumers prepared to buy in bulk. However, notably, margins in UK and USA are similar with the best operation retailers achieving 6% or 7%.

4.4.3 Lessons from America?
Despite such important differences, however, valuable lessons can be learned. In the USA, concerns over the impact of ecommerce on retail values have led several shopping centre owners to find innovative ways of using the Internet to complement existing store patterns (e.g. Simon Property Companies ‘clixnmortar’ offshoot). Key trends from the USA include:

- Continuing strengthening of mall brands;
- Trends towards malls which incorporate ‘shoppertainment’ (Figure 4.12), a coherent and compelling blend of shopping and entertainment (e.g. Simons Mall of America, Mall of Georgia, Metreon Complex in San Francisco and Mills Corporation’s Block in Orange, California);
- Hybrid malls which combine ‘mixed media’;
- Instore kiosks and ‘kiddie cards’.

Two case studies that show how retailers and developers can marry the best of virtual and physical worlds are now presented.

4.4.4 Simon Property
Simon Property Group Inc., based in Indianapolis, Indiana, is a self–administered and self-managed REIT, and is the largest publicly traded retail real estate company in North America with a market capitalisation at the end of 1999 of $17bn. Through its subsidiary partnerships, it is engaged in the ownership, development, management, leasing, acquisition and expansion of income-producing market dominant retail properties. At the end of 1999 the company owned or had an interest in 259 properties comprising regional malls, community shopping
centres and speciality and mixed use properties with some 17million square metres (185 million square feet) of gross lettable space in the USA and five assets in Europe. Shopper visits to its centres total some 2.3bn annually.

The company has pioneered a number of initiatives designed to increase its success and build a ‘relationship model’ with both its shoppers and tenants:

- Simon branding campaign: Launched in 1999, the object of the campaign was to create a distinct identity for Simon’s national network of malls, increase shopper loyalty and create a national communications platform to enable one-to-one customer marketing. This has also been reinforced by the MALLPeRKS shopper loyalty program which operates a points system for dollars spent in Simon centres. Gift certificates (soon to be replaced by a smart card system) have also underpinned this. There are now more than 140 shopping centres with the Simon brand across the USA. Successful branding is promoted through allowing the centres to retain their individual identities. The Simon brand is, however, carried through onto entry doors, parking lot banners and other signage areas. Simon Brand Ventures with partners Turner/Time Warner is expected to lead to the introduction of the Simon Live Media Network, which will further strengthen branding through an in-mall TV network.

- Simon’s multi-tiered Internet strategy was also announced last year. This operates at a number of levels:
  - shopsimon.com, which comprises company portal and individual web sites for Simon malls
  - clixnmortar.com, a venture-creation firm which is designed to combine physical and online retailing (Figure 4.13). It does so through such schemes as ‘Fast
Frog’ and ‘Yoursherpa’. Fast Frog is a teen wish list which uses personal digital (PDAs) assistants to scan product bar codes which can then be uploaded to a website for family and friends who can then order. Yoursherpa also uses PDAs for mid-to-high income baby boomers with a lot of shopping where products can be seen and ordered for later delivery/collection without queuing. Both products have been piloted in Atlanta. Over the 12 month period that Fast Frog was trailed it generated more than $7mn of merchandise in 7 stores.

- TenantConnect.net (now Merchantwired), a national broadband extranet, was also launched in 1999. Developed through a strategic partnership with other developers (including General Growth) and partners, the aim is to benefit retailers and shoppers by providing a cost-effective platform for retail initiatives such as:
  - just-in-time ordering
  - customer email service
  - instore kiosks
  - multimedia shows

Based on the premise that customer acquisition is more expensive (because of advertising) for pure-play retailers than bricks and clicks retailers, and that the web is used most frequently for research rather than purchase, Simon plans to use the benefits of online searches to boost in-store sales. The company’s surveys have suggested only 5-9% of its shoppers with Internet access buy online.

Typical of the scale of Simon’s regional centres is the Fashion Centre at Pentagon City, Virginia (Figure 4.12). Opened in 1989 the centre is 92,000 square metres (989,000 square feet) anchored around Macy’s and Nordstrom. With more than 170 stores, a Ritz-Carlton hotel, office space, a metro station and 4,500 parking spaces, the mall is the second most productive in terms of sales per square foot in Simon’s portfolio.

Ecommerce has not so far impacted negatively on this centre, which focuses on clothing stores, nor is it expected that it will. The average sales per square foot are close to $800 and percentage leases (based on gross sales, with a minimum rent and breakpoint) are relatively short at ten years or less. There is no sign of declining sales densities and the company has made sure it has acquired strongly performing assets, which, together with strong economic growth, has led to increasing sales. Recently up to 50 leases have been restructured and realigned to get the right tenant mix in the Fashion Centre. Retailers potentially under threat from ecommerce, which included two bookstores, have been excluded and replaced with other more profitable stores. Continued aggressive re-tenanting has therefore paid dividends and is designed to provide income security for the company in the future. As Simon’s ecommerce strategy evolves, the centre is about to be updated with new technological infrastructure (MerchantWired) ahead of its refurbishment over the next 5 years. This will mean thinking innovatively about how to incorporate Internet sales and goods returns within wired lease structures for retailers. Returns are a particular concern for landlords because they can reduce turnover figures and rents.
Loved by the analysts, in summary Simon has adopted a clever ecommerce strategy over the last two years, which distinguishes buying and shopping but integrates the two activities in a bricks and clicks format. However, the company does not see ecommerce as a major threat; only where leases come up for renewal would a ‘wired lease’ be introduced. The company will continue to promote effective performance through seeking a strong mix of retailers in its centres.

4.4.5 Discovery Channel Store, Washington DC

In the brave new world of retail, experts believe the future lies in ‘shoppertainment’. One of the most successful examples of this is the chain of retail stores developed by Discovery Communications Inc. Discovery Communications is a cable channel broadcasting in 150 countries world-wide, and includes The Learning Channel, Animal Planet and Discovery Channel. In 1995 the company entered retail by buying the US chains Discovery and Nature.

The Discovery Channel store in Washington DC (see Figure 4.12) is the flagship store of the company and focuses on ‘entertainment retail’ or ‘themed retail’. The store is a crossover between education and retail and combines TV and retail. The destination-sized, four-storey, 2,780 square metres (30,000 square feet) store in the MCI Center in downtown Washington extends the strong brand of the Discovery Channel and uses the retail focus to build on the education and entertainment aspects of the Channel. The ground floor of the store focuses on the geological history of the earth and continues upwards on the floors above through animal habitats and earth cultures to outer space, matching a variety of retail products to the themes displayed.

As one of 11 stores across the country, the flagship store includes some unique features:

- MediArc, a 36 screen 270 degree array for audio visual displays
- Life-size cast of the world’s largest T-Rex skeleton
- Cabin Elevator with sound effects themed to each of the four floors
- Interactive kiosks and displays on each floor
- Discovery Channel theatre with 80 seats.

The company plans to integrate the store even more closely with its web (www.discovery.com) and TV activities and build up its retail channel and brand image. The company has already opened a much smaller store at Terminal 2 of Heathrow in the UK.

4.4.6 Other recent trends

More recently, the idea of integrating the Internet as part of a multichannel framework has led to the development of two sites in the USA. SalesHound.com (Figure 4.14) allows shoppers to search through more than 250 product categories and...
Box 6 Turnover and wired leases: US and UK evidence

Turnover or ‘percentage’ leases have been common since the 1930s in the USA where they emerged as a result of letting problems by retail developers during the depression. Percentage leases were usually based on rents expressed as a percentage of gross annual sales volume in early US shopping developments, and were ‘protected’ with a minimum base rent that reflected the landlord’s minimum financial requirement. Percentages were also set for additional rent to reflect what the retailer could pay, based on historic occupancy rates, mark-ups and differing products. Rents are increased in such leases by either periodic ‘stepping’, or rent graduations, or through the use of a fixed rent multiplier, such as the Consumer Price Index. Typically percentage rents are set at the following levels in the USA:

<table>
<thead>
<tr>
<th>Category</th>
<th>Super-Regional</th>
<th>Regional</th>
<th>Community</th>
<th>Neighbourhood</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>7%</td>
<td>7%</td>
<td>2%</td>
<td>1.25%</td>
</tr>
<tr>
<td>Clothing/Accessories</td>
<td>6%</td>
<td>6%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Shoes</td>
<td>6%</td>
<td>6%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Home Appliances/music</td>
<td>5%</td>
<td>5%</td>
<td>3%</td>
<td>4%</td>
</tr>
</tbody>
</table>

However, in the USA, research by the Urban Land Institute has shown that base rents are the most important part of rental income, representing something more than 90% of total rental income for regional centres and 97% for neighbourhood centres (ULI, 2000). Older centres in fact also tend to have a higher proportion of income from turnover than younger centres.

There are important differences between US and UK turnover leases:
- Leases in the US tend to be shorter generally (5-10 years is common in regional malls);
- Base rents in the US are based on ERV, rather than on a percentage of ERV. Hence the turnover element is squeezed in the US.

In the UK, turnover leases in retail were relatively rare until the 1970s. Since then, a number of property investors and developers have implemented turnover leases in new retail developments.

Turnover rents are believed by many to encourage more active management by landlords because, for example, the maximisation of tenant income is promoted. Against this, others have argued that the accuracy of sales reporting by tenants is questionable and that financial institutions may be wary of lending on such schemes, because of the lack of certainty of income.

In the UK the percentage is usually based on net turnover after deducting such items as VAT, sales to staff, and returns. In addition, the percentage is usually fixed for the term of the lease although variations may occur depending on changes of use and occupier changes.

In the UK three main types of agreement can be identified:
- Pure turnover (rent is a percentage of turnover);
- Base rent plus turnover (e.g. 80% of ERV for base rent plus a percentage of turnover, say 1-2% for supermarkets and clothes shops/restaurants, 10%);
- Base rent, or turnover-related income (i.e. a fixed based rent as a percentage of turnover or percentage of turnover, whichever is higher).

Data from IPD and the University of Reading showed that in 1998 3.67% of shopping centre units were on turnover leases.

Integration is a lesson many US retailers have learned. Most retailers now allow customers to return goods purchased online to their stores. Other retailers use in-store kiosks for customers to order goods which are not available in the store and have them delivered by the next day at home or for collection.

But this poses problems for the landlord. If a sale occurs at a store’s kiosk, should that count towards turnover in the store? What about goods returns: should they be included, and should stores advertise websites?

There is a case for saying that any store transaction counts towards turnover. Returns could pose a real problem as some 25% of Internet purchased clothing is returned. Ultimately the secret lies in sound drafting of leases and integrating channels. For example, a recent National Retail Federation Survey found that 60% of Internet shoppers visiting websites went on to buy items from their stores and that 66% of catalogue shoppers bought from catalogue stores. Multichannel can therefore bring benefits.
30,000 brands to see what is on sale at their local shopping centre. MyShoppingCenter.com is another site, which provides a range of Internet services to shopping centres and their tenants, enabling them to set up web pages, offer coupons to shoppers and interact with retailers.

4.4.7 Implications for UK shopping centres
The case studies in this section have highlighted some emerging themes from the US experience:

- The first-mover trend by the large US property companies towards large-scale web-enablement of retail-based supply chains in their shopping centres. This is on a different scale from anything so far attempted in the UK
- The increasing importance of ‘shoppertainment’ as a key theme in US retailing, combining the best elements of shopping and leisure in store and centre design
- A trend towards restructuring of existing landlord and tenant relationships in the US, perhaps made easier by the sheer consolidated scale of the major US property developers/investors, the dominance of the turnover leases, absence of security of tenure, upwards only rent review clauses, and the presence of shorter leases.

Although the UK can learn from the US experience, and although ‘shoppertainment’ is already a theme that is well recognised over here, the sheer scale of restructuring supply chains and leases in shopping centres is therefore unlikely to appeal to more conservative investors/developers in the UK. Nonetheless, if the wired and bricks and mortar worlds are to be combined effectively, ‘wired leases’ may well become an important part of the UK scene over the longer term.

In the UK, there has been much debate about how wired leases, which can capture Internet sales, might work. The suggestion is that such leases should be based on a percentage rent, based on retailer’s sales generated through the shopping centre store, and a percentage of sales made through the centre’s Internet sites, so capturing ‘rent’ from multichannel retailing. Wired leases have been promoted by JLL in the UK, with Land Securities and Richardson Brothers alleged to be considering such leases in Birmingham and Manchester (Printworks Development). The results of our survey suggest there is still a long way to go before such leases become anything more than a talking point.

Nonetheless, already in the UK investors and developers are looking at new ways to develop stronger synergy between themselves and retailers. As one of our UK investor/developer interviewees put it:

‘Ecommerce is clearly an opportunity for retailers. But perhaps not in the way that the US trend has taken off. We think the opportunity is in enhancing our intelligence and therefore our ability to continually evolve them, both from a consumer and tenant point of view of view. So if you web-enable information flows from which you can capture stuff, and if you capture it you can mine it, and then you can continually evolve the physical offer, the content within the centre, the brand, its presence and what its meaning is with the people that want to interact with the brand….The value of brand marketing is the brand value that you can build way beyond the traditional catchment definition.’
4.5 Summary
This section has summarised current thinking and research on the potential impact of ecommerce on retail property in the UK and USA. The relatively new introduction of ecommerce makes it difficult to draw a consensus of opinion from the variety of research carried out. However, some key themes to emerge are as follows:

- The timescale of the impact is uncertain;
- Some retail property sectors are more at risk than others;
- Financial services and other services are likely to be highly impacted;
- Polarisation between existing retail subsectors will probably increase;
- The extent to which B2B savings in retail will offset squeezed retail margins is uncertain;
- The real estate cost advantage of pure-plays may be overstated;
- Turnover leases are likely to be impacted to some degree;
- Retailers’ space requirements are also driven by corporate balance sheet restructuring and refinancing;
- In the UK, parallel accounting standard changes are likely to have an impact; and,
- Despite cultural differences, valuable lessons can be learned from the US experience of ecommerce.

Of course, visions of the future differ markedly and so new research is needed to clarify the outcomes and solutions to the impact of ecommerce on UK retail property over the next 5 years. The next section describes the way the research was carried out before presenting the results.
5 RESEARCH QUESTIONS AND METHODOLOGY

5.1 Research questions
The literature and research review highlighted a number of key questions which the current research seeks to address. These are anchored around three main areas of interest and comprise:

Retailers’ and investors’/developers’ perspective
- How is ecommerce developing in UK retail?
- What are the barriers and drivers to ecommerce?
- How important is ecommerce for retailers alongside other issues such as changes in accounting standards and shorter, more flexible leases?
- How are UK retailers’ property requirements changing as ecommerce evolves?
- Are etailers’ property requirements different from conventional retailers’?
- How and when will ecommerce impact on retail in the UK?
- What is the likely future path of ecommerce in UK retail?
- What lessons, if any, can be learned from the USA?

Shoppers’ perspective
- What do shoppers think about ecommerce?
- Is there a digital divide?
- What products and services are under threat from the Internet?

Forecasting the future of ecommerce – the potential impact on sales and rents
- How can we forecast the future size and impact of ecommerce?
- What is the impact in the UK at a national level and town and shopping centre level in terms of impact on sales and rental values?
- What are the problems and issues associated with such forecasts?

5.2 Methodology
Our empirical research, which was carried out during June 2000 to December 2000, comprised the following:
- Postal questionnaire survey to UK retailers, investors/developers and their advisers;
- Structured face-to-face interviews with leading experts in the field;
- Case study of Cyberton (a large town in the South East of England) using a shopper survey, a retail focus group and live shopping centre data.

This was underpinned with three scenarios, which were used to highlight the potential impact on rents of loss of trade from conventional channels to ecommerce. The three scenarios adopted were ‘sluggish’, ‘growing’ and ‘rapid’.

5.3 Postal questionnaire
A postal questionnaire survey was conducted to gather the views of retailers, retail property investors and their advisers about ecommerce and its future impact on retail real estate. Three questionnaires were prepared for each target group, with a selection of questions customised for the appropriate group. In addition there were a set of core questions, common to all
questionnaires. These mainly gathered general views about the size and timing of a potential impact and the types of retailing establishments most at risk.

Overall 263 usable questionnaires were returned, representing a response rate of 12%. Of these 156 were from retailers (11% response), 77 from investors and developers (15% response) and 33 from surveyors (15% response). In addition six questionnaires were returned from pure-play Internet retailers.

The reasons for non-responses vary but are likely to include the following:

- Many large retailers have a policy of automatic refusal to all questionnaires. Some were redirected to BCSC representatives in these companies which did result in extra responses.
- Some developers, investors and investment advisors felt that they were unqualified to respond, or were not fully involved in the retail sector to be of assistance.

Responses were received from many different retail sectors and included retail banks, building societies, travel agencies and charity shops (Table 5.1). Responses were received from large well-known national multiples as well as small independent chains. A profile of the retailers by sector and size of branch network is shown in Table 5.1 and Table 5.2.

### 5.4 Retailer survey-size breakdown

Compared with national data from the ONS (Table 5.3), our sample has a large proportion of retailers with large store networks. Retail concentration is high in the UK, however, with the top ten retailers accounting for over half the total turnover of the top 800 retailers in the UK (Retail Intelligence, 2000).

Clearly the large retailers will punch a greater weight in terms of the importance of their views.

To get a better idea of whether our sample was potentially skewed we looked at how many of our respondents were in the Retail Intelligence Retail Rankings. Table 5.4 shows that five of the top 10, 13 of the top 50 and 16 of the Top 100 were included in our sample. Therefore we believe our sample reflects the high concentration of the UK retail industry. It should also be stressed that our research included interviews with large retailers.

To highlight the importance of the views of the large retailers, we also highlight key results in the main findings section by size of company.

| Table 5.1 Responses from retailers by sector |
| SECTOR | NUMBER OF RESPONSES | % OF ALL RESPONSES |
| Clothing and footwear | 26 | 17.1 |
| Banks and building societies | 14 | 9.2 |
| Electrical goods | 13 | 8.6 |
| Not known | 13 | 8.6 |
| Furniture and floor coverings | 10 | 6.6 |
| Sports and outdoor goods | 9 | 5.6 |
| Food and groceries | 8 | 5.3 |
| Household goods | 7 | 4.6 |
| DIY and motoring | 7 | 4.6 |
| Booksellers | 7 | 4.6 |
| Stationers, cards and art supplies | 7 | 4.6 |
| Jewellers | 6 | 3.9 |
| Travel agencies | 6 | 3.9 |
| Music and video | 4 | 2.6 |
| Health and beauty | 3 | 2.0 |
| Co-operatives | 3 | 2.0 |
| Toys | 3 | 2.0 |
| Garden centres | 2 | 1.3 |
| Charity shops | 2 | 1.3 |
| Department stores | 1 | 0.7 |
| Florists | 1 | 0.7 |

| Table 5.2 Retailers by number of branches |
| NUMBER OF BRANCHES | COUNT | PERCENTAGE |
| 5 or less | 55 | 36% |
| 6 to 15 | 29 | 19% |
| 16 to 49 | 29 | 19% |
| 50 or more | 39 | 26% |
| Total | 152 | 100% |

| Table 5.3 Responding retailers versus the national distribution |
| NUMBER BRANCHES | % OF RETAILERS OF RESPONDING TO POSTAL QUESTIONNAIRE | % OF RETAILERS NATIONALLY (ONS) |
| 1 outlet | 1.3% | 88.5% |
| 2 to 9 | 49.3% | 10.9% |
| 10 to 99 | 28.3% | 21.1% |
| 100 or more | 21.1% | 9.7% |

| Table 5.4 Responding retailers in Retail Intelligence’s Top 800 rankings |
| RANK | CUMULATIVE NUMBER OF RESPONSES |
| Top 800 | 41 |
| Top 200 | 20 |
| Top 100 | 16 |
| Top 50 | 13 |
| Top 10 | 5 |
5.4.1 Investors and developers

A list of developers and investors was obtained from Freeman’s Guide to the Property Industry to which questionnaires were sent. 92% of respondents held retail property within their development or investment portfolios and 60% held leisure property. However, office and industrial real estate also constituted substantial proportions of these companies’ assets as shown in Table 5.5.

Retail property makes up a mixed proportion of respondents’ portfolios, although most (83%) have up to 60% of their portfolio, by value, held as retail as demonstrated in Table 5.6. When these portfolios are valued there is also a wide spread of values. 48% of respondents have retail portfolios valued at less than £50m and 52% are valued at more than £50m. 14% of responses came from the largest value category – retail portfolios valued in excess of £500m.

5.4.2 Investor advisers

Questionnaires were sent to chartered surveyors who appeared under the retail specialisation lists in the RICS’s directory of firms for 2000. 33 usable responses were received from the sample and most had been completed by either Directors, Senior Partners or Heads of retail departments.

5.5 Face-to-face interviews

A series of face-to-face interviews were conducted during November and December 2000. In addition two telephone interviews were conducted in December 2000 and January 2001. In total 10 people were interviewed:

- 5 physical retailers with varying levels of exposure to the Internet. All were major high-street names and all appear in the top 100 list of retailers according to Retail Intelligence’s Retail Rankings for 2000. Three appear in the top 10. Positions held by interviewees included senior roles in e-commerce, property and finance departments.
- 1 pure-play etailer (founder and Director interviewed).
- 4 investors/developers (senior directors and/or researchers interviewed).

5.6 Cyberton

5.6.1 A case study

We also selected a case study town in the south east of England. Cyberton has a high degree of Internet access and has a major primary shopping centre. Our Cyberton study comprised three elements:

- a retail focus group with local retailers to seek their views on the impact of the Internet;
- shopper surveys in Cyberton town centre; and,
- further case study work on the impact of ecommerce on turnover and rents in the Shopping Centre.
5.6.2 Shopper surveys

Two survey days were chosen in early October 2000 to conduct the shopper survey, a Wednesday and a Saturday. This was viewed to be the most appropriate time since it preceded the major Christmas shopping periods and followed the rush of ‘Back to School’ shopping. Six interviewers were used and were placed within the town’s main shopping zone, and outside the main covered shopping centres. In general the weather on both days was fair; however, the second day was cut short by rain. Despite this a total of 469 people were interviewed over the two days.

Interviewers were located in pairs on three sites around the town centre at the following locations:

- Location A: Outside the main entrance of the town’s primary shopping centre.
- Location B: Outside the main entrance of the town’s secondary shopping centre.
- Location C: Along the main shopping street in the town occupied by a number of national multiple retailers.

Characteristics of survey respondents

Over the two days 39% of respondents were male and 61% were female. The mid-week survey showed a large female response with 2 out of every 3 responses coming from women. However, the weekend survey displayed a more even split with 47% of responses from men and 53% from women. This compares favourably with demographic data for the Cyberton retail catchment.

The age profile of the respondents shows that 25 to 44 year olds are the dominant shopper group with 53% of responses coming from this age group in the weekend survey. This is a

![Figure 5.2 The ACORN targeting classification to group level together with profile of shoppers responding to survey](https://example.com/research/image)
much larger proportion than for the resident population where 32% of the population are of this age. Other contrasts with resident population include:

- An over-representation of 15 to 34 year olds and 65 to 74 year olds in the mid-week survey.
- An over-representation of middle aged people and an under-representation of elderly individuals in the weekend survey.

The majority of respondents came from Cyberton and its associated suburbs, within the town’s primary retail catchment area. Using postcode data together with the ACORN targeting classification system developed by CACI, respondents were categorised by their consumer characteristics. The makeup of ACORN is shown in Figure 5.2 up to group level. The classification is based on data from the 1991 UK Census and is split into 3 levels: categories, groups and types. There are 6 ACORN categories represented by letters A to F. This is broken down into 17 groups (as shown in Figure 5.2) and then into 54 types.

CACI also have classified postcodes using their own eType classification. A profile for every postcode sector is available giving the proportions of each category of Internet user. Using the sample of shoppers from the street survey, it is possible to produce an ‘average’ expected profile for the sample based on CACI data.

Figure 5.3 shows this expected profile. Over two-thirds (68%) of the sample would be expected to be offline consumers.

5.7 Scenarios

5.7.1 What do the scenarios comprise?

Section 2 of this report showed that there are a variety of views on the size of the future online ecommerce market in retail. To better understand how ecommerce might impact on retail sales in the UK, we developed three scenario-based models for the period 2000-2005. This develops and extends the work by Miller (2000) and DTI/Foresight (2000) and CRIC (1999).

The three scenarios are shown in Table 5.7 and comprise ‘Sluggish’, ‘Growing’, and ‘Rapid’. All three scenarios are based on the assumption of 0.6% online sales share in 2000 (or £1.24bn) as a percentage of all retail sales. This is a little less than Verdict’s 2000 estimate of 0.7% mainly because we have assumed less optimistic Christmas online sales in 2000 than Verdict’s forecast of treble the 1999 level.
5.7.2 What are the aims of the scenarios?
The scenarios offer differing views of how ecommerce may impact on UK retail over the next 5 years. In particular, they are designed to show:

- How ecommerce might divert potential offline sales to the online channel;
- How this effect may vary across different types of good; and,
- How the potential lost store-based sales may impact on rental growth prospects nationally and locally.

The scenarios are not intended to be precise forecasts but are designed to indicate the possible impact of ecommerce over the period 2000-2005, depending on the assumptions within the scenario adopted.

National scenarios were prepared, and the same scenarios carried over to a local level to our case study, Cyberton.
MAIN RESULTS

Introduction
The following sections incorporate results from the postal survey, interviews, retail focus group and shopper surveys around key, themed research questions. The results section comprises three parts based around the following:

Section 6 The Retail and Property Perspective
- How is ecommerce developing in UK retailing?
- What are the barriers and drivers to ecommerce?
- How important is ecommerce for retailers alongside other issues such as changes in accounting standards and shorter, more flexible leases?
- How are UK retailers’ property requirements changing as ecommerce evolves?
- Are etailers’ property requirements different from conventional retailers’?
- How and when will ecommerce impact on retail in the UK?
- What is the likely future path of ecommerce in UK retail?

Section 7 Shoppers’ Perspective
- What do shoppers think about ecommerce?
- Is there a digital divide?
- What products and services are under threat from the Internet?

Section 8 The Future Impact of Ecommerce on UK Retail Sales and Rents
- What will be the likely impact on retail sales and rents in the UK?

At the beginning of each section we summarise the key points emerging.
Key Points

Use of the Internet in UK retail

- A large majority of UK retailers in the sample have websites, but only half are transactional. The use of Digital TV, Internet kiosks and mobile telephones is also expanding amongst larger retailers.

- Multichannel strategies appear to dominate. Nearly half of all UK retailers in the sample were looking to integrate the Internet within the existing business. Ecommerce is seen by many retailers as an opportunity but also poses key threats.

Barriers to Ecommerce

- Customer fulfilment and security issues were seen as the most important barriers. Bandwidth was not so important as these elements. Logistics and delivery issues were an important consideration. Strong brand underpins security.

Importance of Ecommerce as a Burning Issue

- Ecommerce is having a major impact in retailing but local factors are important to consider at a town level.

- Accounting changes are a major concern, especially for larger retailers.

Retailers’ changing property requirements

- The retailers in the sample traded predominantly from high street stores, but in-town and out-of-town shopping centres locations were also important.

- Leasehold ownership dominates with some 61% of space in the average retail portfolio held on this form of tenure. Larger retailers tend to hold more leasehold (76%) space. In contrast, our previous analysis of retailers’ accounts and balance sheets suggests the value of freehold property is higher than that of leasehold in typical portfolios.

- Those retailers with leasehold property are holding on leases of more than 10 years. A large majority of the largest firms (77%) had lease agreements in excess of 10 years. Retailers would prefer shorter leases. 71% of the largest retailers would prefer leases of 10 years or less.

- Turnover leases were part of the overall lease framework. Some 37% of retailers with leases had part of their store portfolio on this type of lease. However, for 70% of retailers turnover leases were 10% or less of their portfolios. Two types of turnover lease dominated for retailers and investors/developers: fixed rate plus additional rent or higher of base rent or turnover.

- Retailers are bullish about their future space requirements. Some 65% of retailers want to increase their space over the next 3 years, but there is no change envisaged for distribution and office space. Those retailers with little freehold property in their portfolio were keen to expand their retail space, especially increasing the number of stores.

- Retailers do not believe that the Internet will reduce the demand for space. But one third of the largest retailers are considering property restructuring and refinancing, reasons which include the need for greater flexibility and property market dynamics. The majority of retailers expect their occupation costs to increase over the short to medium term.
Key Points (continued)

Etailers
- Etailers still need property to operate.
- In the sample the five etailers occupied a variety of space including call centre offices and business units. Three wanted to expand retail space by opening physical stores, whilst the other two wanted to expand office/destination space. Etailers also expect their occupation costs to increase.

Values, yields and returns (2000-2005)
- Respondents were divided in their view of ecommerce and its impact on values, yields and returns. Almost half of all respondents indicated that each of these was at low risk from ecommerce. A majority of investment advisers, however, believed ecommerce to be more of a risk. Retailers were even less convinced at the risk element (i.e. less risk averse). Retail capital values and total returns were all expected to fall, however. The majority of respondents felt that ecommerce would impact within the next 5 years. Investment advisers felt the impact would come soon rather than later.

What Property is at Risk?
- Properties occupied by banks and travel agencies are seen to be most at risk by all respondents.
- Prime standard shops, large city shopping centres and out-of-town regional shopping centres are seen as least at risk.
- Comparison shopping was seen to be most at risk, especially in secondary locations. Convenience shopping was seen as ‘safer’ and investors/developers see niche retailing to be the least risky of the sectors. Large cities may also be more immune to the negative impacts of ecommerce.
- Rumours of the death of the high street are false.
- Including the ‘shoppertainment’ element will help combat the threat of ecommerce.
- Polarisation of prime and secondary is likely to continue (72% agreed this would happen). It is too early to say that B2B and wired leases will be important in the UK although some interviewees felt B2B would impact soon.

Other issues
- B2B efficiencies in retailing and the development of wired leases have some way to go yet in the UK.
- Digital TV and mobile are seen as becoming increasingly important in a multichannel future.
- The most successful retailers will be those that build on a strong brand and integrate online within a multichannel environment.
- Kiosks and interactive services will also become important.
- The future for pure-play etailers is seen as difficult. ‘Bricks and clicks’ is more compelling.
6.1 How are retailers responding to ecommerce?

6.1.1 How is ecommerce developing in UK retailing?

Previous research has shown that a large majority of retailers have websites. Our research confirmed this, with 82% of respondents having websites. As Figure 6.1 shows, the largest retailers made most use of a website, with only one company not having a site. This clearly raises the overall average penetration figure, but even so the small and medium sized retailers still have a high level of website use.

Not all these websites are transactional, however. For example, just under half of those retailers with a website used it to disseminate information only (Figure 6.2) and a similar proportion said it allowed online transactions. This represents 40% of all the retailers who responded.

Transactional websites tend to be favoured by the larger retailers (based on number of stores), with two-thirds of this group having such sites. On the other hand, well over half of the smallest retailers had information-only sites.

Retailers were also asked if they had a presence on other interactive media channels. As with transactional websites, the larger retailers tended to offer these services more than smaller businesses. Some 7% of all retailers said they had a presence on digital television, 4% on Internet kiosks and 8% on web-enabled mobile phones. As Figure 6.1 shows, a greater proportion of larger retailers were making use of these more sophisticated sales channels.

Retailers were also asked how they would describe their current online business model (see Figure 6.3). Around one-third said their strategy was purely information only and nearly half of the sample said the Internet enterprises were integrated into the rest of their retail operations. This suggests that many retailers are using their expertise and knowledge developed in a store-based environment and applying it online. Very few were developing separate business units for the web-based activities and none of our respondents were only targeting export markets.

Of those retailers with websites, 73% said they had plans to expand their Internet capabilities. A variety of plans were suggested, but many of those retailers with information-only sites were considering developing a transactional website. Retailers
already at this stage were considering expanding the product range on offer over the Internet, but many said they were constantly reassessing the website and exploring opportunities for its expansion.

Our interviews revealed that mergers and acquisitions of etailers by bricks and mortar retailers were occurring and a multichannel strategy was favoured by many. It was clear from the interviews and Cyberton focus group that retailers saw the Internet as an opportunity rather than a threat and expected ecommerce to be integrated within existing business models. Ecommerce would represent another retail channel and expand capacity of the market, which might, in some circumstances, exert a potentially depressing effect on profits. However, retailers expected that the impact on individual businesses would be more a function of products and individual marketing skills:

‘… we don’t think it will, in its present form, damage our business enormously. And the reason why I say that is our kind of shopping is very much impulse shopping. It’s not mission shopping. You go to an outlet business because you’ve got a bit of money in your pocket and you’re curious about how you might spend it. You’re going to regard spending as an end to itself. It’s fun, it’s entertainment. You’re going to buy almost anything you can find.’

Retailer

‘As long as people buy our brand, or buy our product, it doesn’t really bother me whether they come into the shop to buy it, whether they shop it on the net, whether they shop it from a home catalogue. So long as we are using our marketing skills to reach those different people. And if they come to Cyberton as a town centre and enjoy the experience, well they can still buy the product from Cyberton in the comfort of their own home. So I see it very much as an opportunity’.

Cyberton retailer

‘Customers don’t define their needs by channel, they define it by product, by brand, by physical characteristics. They’ll shop you in the way they find most convenient. And it won’t always be the same way for any individual person. The fact that we buy all our groceries online from X doesn’t stop me going into X on the way home and buying stuff. So they’re missing out if they don’t have a full online presence’.

Retailer

Retail investors took a slightly different view. At the macro level one reasoned that the greatly increased opportunity for customers to source goods from a much wider area must result in a net reduction in the number of purchases from traditional retail areas. While opportunities existed for creative thinking in the way shopping centres are managed to mitigate those effects, it has to be recognised that a small loss of trade can impact substantially on retail profits.

‘… shops are in a way intermediaries between producers and consumers, and therefore are vulnerable to disintermediation processes. … So in that sense I would expect some sort of
aggregate net hit on the underlying economic fundamentals underpinning retail property, i.e. sales and turnover.

But I think the opportunities come in the creative thinking about how you make use of these highly visible physical assets, and the potential to inter-relate that with e-commerce based initiatives, whether in the mall itself or from the perspective of a landlord to the tenants in that mall. For instance we may be able to help those tenants by other services in an aggregate sense. So there’s B2B plus B2C type benefits that a smart landlord could hope to add as income to the business or to the client fund”.

Investor

“What you’ve got bear in mind is with retailing it’s a business with quite a high fixed cost base, so there’s a lot of operational leverage. So you’ve only got to lose 1% of your trade and you could be losing 5-10% of your profits. So even though the impact of e-commerce in raw terms may actually be fairly small – couple of percent level – that might be enough for certain businesses for it to be quite a significant impact on their profitability.

… So ultimately that must have a knock on impact on the value of retail property. You can’t sustain retail property if there’s no-one there to pay the rent.’

Investor developer

6.1.2 What are the barriers and drivers to ecommerce?

All respondent groups were asked to identify potential barriers to the future growth of UK retailing on the Internet. As with other issues, there was very little difference in opinion between retailers, investors/developers or their advisers. Figure 6.4 displays aggregated responses.

Customer fulfilment and security issues were seen as the greatest problems facing online retailing, both of which had high average scores indicating high importance. This supports the findings of other research. Poor customer fulfilment and security are therefore seen to deter many potential consumers from buying online and using online services such as banking. Customers need to be reassured that their personal data will be safe, and that they will receive goods quickly with little hassle.

Bandwidth limitations were not seen as a significant barrier, except amongst investment advisers who ranked it higher than retailers and investors/developers. This is surprising because most of the UK population currently only have access to relatively low bandwidth Internet access at home, making it difficult for widespread access to unmetered services and downloading of music and video files.

The face-to-face interviews echoed issues about security and customer fulfilment. The key to countering security problems was perceived to be a function of securing customer trust through:

- establishing brand strength;
- developing a recognised ‘pitch’ on the Internet; and,
- maintaining a physical and visible presence in the high street.
Customer fulfilment was currently linked to the value placed on the interaction with people and products through high street shopping, coupled with the instant gratification of an on-the-spot purchase.

‘Sometimes, certainly in our industry, a lot of the purchases or some of the purchases are sort of treats for [your]self when you’ve had a bad day and you buy something to take home. We don’t want to lose out – we need to keep an eye on that – make sure our stores still have the right stock in.’

Retailer

The barriers to customer acceptance of ecommerce might be countered by:

- advances in the technology, enabling customers to get a better ‘feel’ for products offered on-line;
- improvements in delivery logistics;
- greater IT literacy in the customer base; and
- the opportunity to access Internet sites from within town centres and stores.

Avoidance of the high street might be more likely to come about through other factors than ecommerce, such as increased travel costs or changing customer attitudes to what constitutes safe shopping environments.

‘The biggest stumbling block rather than access is security. From what we understand within our own catchments and the broader European research there is still a very large fear… and until digital description becomes the norm I can’t see that changing’

Investor / developer

‘It’s the people who have the high street presence that actually do better, because there’s a comfort factor. Tesco’s a great example of that … you actually trust these people to give them your credit card details and your address, and actually be a human face. I think people need that. They don’t want to move away to a world where they’re dealing with a virtual person via e-mail. They want the facility where if they’ve got a product that is faulty or they don’t want it for any reason they… can take it back to a store and see a real person, and walk around and see what we stand for in a physical environment’.

Retailer

‘There are some natural barriers that are social, and perhaps the technology can get round this in some way. I would still see the interaction of the town centre, whether it be for leisure or retailing, and the instant gratification of retailing, I still see that as the sort of marketplace – where people meet and things happen…

Then the technology – if I could feel it, play that guitar, try that suit on somehow through the screen and be convinced that it fits me and I like it, well maybe I might be more inclined to buy more things on it. And maybe the technology will get there at some stage.’

Investor / developer

‘Let’s imagine that you’re sitting at home with the net… you’ve got to arrange for all this to be delivered to you. With our road system and with our logistics it will mean that six vans
will all turn up at the same time, which you don’t need, and it will mean immense problems. There is no way that this country, with its road system and supply system and logistics, can possibly cope with people sitting at home expecting 20-30 deliveries per week.’

Investor / developer

‘I think something else we really need to recognise is the customer base in Cyberton is far more technologically minded than the average town centre within the UK. Which means we as retailers could be a little bit behind what the customer expectations are. We could be a bit more technologically afraid than the customers. Something else as a town we should be looking for is giving customers the facilities to access Internet sites within the town centre. That’s very, very limited at the moment’.

Cyberton focus group member

6.1.3 How important is ecommerce for retailers alongside other issues?

Interviewees and focus group saw ecommerce as a very important issue for retailers, but it was acting as a stronger force for change in some businesses than others, as illustrated by the quite different responses from retailers in entertainment and fashion:

‘It’s fundamental – absolutely fundamental. … We believe there’s no real future in remaining in a bricks and mortar environment because of all the added value you can offer online. … Being a pure-play retailer online is difficult with economics, because it’s a very low margin business. The real opportunity for growth is a combined strategy of having bricks and clicks, so it’s fundamental for our progress in future.’

Entertainment retailer

‘I’m afraid e-commerce plays no part whatsoever in looking at our property strategy at the moment. It’s such an insignificant part of our business and that’s the way we see it for the foreseeable future.’

Fashion retailer

Other issues were also important, particularly at a local level. For example, the focus group highlighted the issues of:

- local accessibility and parking in the town centre; and
- skill shortages in retailing which were leading to technological innovations.

Retailers were also concerned about the recently proposed accounting changes to the treatment of leases and how it would affect their businesses. Figure 6.5 shows how all retailers responded to this question in the postal survey according to the size of their branch network. The majority of small retailers (66%) said that there would be no effect, but a much higher proportion of the large retailers thought there would be some effect (60%), especially in a trend towards shorter leases (44% of large retailers).
6.1.4 How are retailers’ property requirements changing as ecommerce develops?

**Occupied space**

High street stores are the dominant form of space occupied by 88% of all retailers responding (Table 6.2). Of these retailers some approximately 50% were medium / large retailers and 50% small retailers with less than 15 stores. Some 37% of the retailers occupy units within in-town shopping centres and 29% within out-of-town shopping centres. For both of these types of centres, occupiers are dominated by the largest multiple retailers (Figure 6.6). Retail parks and in-store concessions are the least used space amongst the respondents, which reflects the limited range of sectors attracted to this type of retailing (e.g. electrical, furniture, DIY).

**Tenure and lease length**

Retailers were asked about the proportions of their portfolio that are freehold or leased under institutional-style contracts. The ‘average’ portfolio held by all the retailers surveyed consisted of 34% freehold property space and 61% leasehold space. Compared to our earlier analysis (Table 4.2) of retailers’ accounts it would appear that our sample had a much lower level of freehold ownership. However, our question was about ‘space occupied’ not ‘value’.

Table 6.3 shows that the larger retailers who responded hold a larger proportion of their property space on institutional leases than smaller retailers. In value terms, however, the freehold element may well outweigh the leasehold element as our earlier analysis showed (Table 4.2).

The largest retailers have the largest proportion of their space held as leasehold (76%), with just 20% of their space held as freehold. The level of institutional leases held by retailers reduces as the size of the store network reduces. The smallest retailers have 49% freehold property and 44% held on institutional-style leases. As one retailer put it, the move towards leasehold may gain speed:

‘I think that’s inevitable…If historically we had been sat on a pile of property assets as opposed to leases we wouldn’t be here today without any doubt at all. Tying up money in property is not really the way retail companies should be judged. Historically this company has always invested its money in the business rather than bricks and mortar…the share price is related to the performance of the business rather than any underlying asset base…’

Those retailers with leasehold property are generally holding it on medium to long-term leases, i.e. over 10 years in length. Some 64% of those renting retail space had agreements of this

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**Table 6.2 Current occupied space for respondent retailers**

<table>
<thead>
<tr>
<th>TRADING SPACE</th>
<th>COUNT</th>
<th>% OF RESPONSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>High street stores</td>
<td>125</td>
<td>88%</td>
</tr>
<tr>
<td>In-town shopping centres</td>
<td>53</td>
<td>37%</td>
</tr>
<tr>
<td>Out-of-town shopping centres</td>
<td>41</td>
<td>29%</td>
</tr>
<tr>
<td>Retail parks</td>
<td>19</td>
<td>13%</td>
</tr>
<tr>
<td>In-store franchises/concessions</td>
<td>19</td>
<td>13%</td>
</tr>
</tbody>
</table>
nature, with 25% having terms of 15 years or more (see Figure 6.7). A more detailed breakdown by size of retailer is shown in Figure 6.8.

This level of long leasehold agreement was applicable for all sizes of retailer with the exception of those with 50 stores or more. For these firms, 77% had leases in excess of 10 years. In addition none of these large retailers said they had agreements of less than 5 years (Figure 6.8).

A major study by the University of Reading for the DETR (2000) showed that over the 1990s the proportion of short-term leases has steadily increased. The most recent figure, for 1998, shows 65% of standard retail leases (adjusted by value) having a term of 15 years or more. The trend is therefore one where long leasehold agreements are reducing in frequency, and the responses to our survey are very much in line with these ongoing changes, considering there is a two year gap between the DETR data and the survey responses.

The University of Reading’s findings are also supported by the responses concerning desired lease lengths. These show a continuation of the downward trend for longer leases (see Figure 6.8). For all sizes of retailers the general opinion was that shorter lease lengths would be preferred. Although respondents were not asked why, this is likely to be due to the increased flexibility being demanded by retailers from their lease agreements. The largest retailers in particular showed the greatest demand for shorter leases, with 71% of them preferring leases of 10 years or less.

Interviewees also expected to see continued moves toward shorter leases and increased use of turnover rents, but due more to general pressure on the retail sector than as a direct result of ecommerce. There was some suggestion that attitudes might vary according to type and size of retailer. For example, multiple retailers whose business is more reactive might be more inclined to direct future investment toward developing ecommerce, coupled with a preference for short leases on physical space. This is in contrast to large stores and warehouse operators that have tended to prefer to secure their position in bricks and mortar in the longer term.

*When you look across Europe, we’re structurally so unsound in our retail property market in the UK, that there has to become some movement, some balancing of the risk and reward between the tenant and the landlord. Certainly turnover rents, possibly the increase in break clauses, probably the need to move away from having upward

### Table 6.3 Average property portfolio for retailers by size of branch network

<table>
<thead>
<tr>
<th>NUMBER OF BRANCHES</th>
<th>AVERAGE PORTFIO</th>
<th>% FREEHOLD</th>
<th>% (INSTITUTIONAL) LEASEHOLD</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 or less</td>
<td>49%</td>
<td>44%</td>
<td></td>
</tr>
<tr>
<td>6 to 15</td>
<td>37%</td>
<td>64%</td>
<td></td>
</tr>
<tr>
<td>16 to 49</td>
<td>27%</td>
<td>68%</td>
<td></td>
</tr>
<tr>
<td>50 or more</td>
<td>20%</td>
<td>76%</td>
<td></td>
</tr>
</tbody>
</table>

*The Retail and Property Perspective*
only rent reviews. I think there’s going to become increasing pressure on landlords to agree to those sort of things particularly now that there’s so much less new shopping centres coming onstream. … I think it’s got to happen, particularly with the state of retail in the UK at the moment, you know there aren’t enough retailers making enough money to be able to maintain the payment of all these rents. But I don’t think that’s really going to come about as consequence of ecommerce’.

Retailer

‘I certainly think shorter term leases – more predominant shorter term leases. The multiples are a different matter I think. The established companies are a different beast from the smaller chains and the independents, because the impact of these guys on Internet retailing and the growth of multiples is going to be enormous. I think they’ll be less likely to sign longer leases. If you had some money to invest and you can buy a single store or you can invest on the web, I think more people will be going more toward the web because it’s the safer option for them. They’re not tied into the real estate and they can be more reactive, and they can reach a wider audience. So I think shorter leases to actually tempt these guys to coming into bricks is going to be important’.

Retailer

Turnover leases

Evidence suggests that turnover leases are increasingly being used by landlords in UK retail developments. In such cases, if ecommerce impacts upon retailers’ margins and profits, this could potentially impact upon investors’ returns. For this reason the survey also asked investors, developers and retailers about their exposure to turnover lease agreements.

Some 32% of retailers with leases had some part of their store portfolio on turnover leases and 43% of the investors and developers had some of their portfolio let on turnover leases.

In general, the small retailers tend not be renting space on turnover leases. Only the largest size category (50 stores plus) has a high proportion of respondents on such agreements (60%), compared to 19% for retailers with 6 to 15 stores and 15% for those with five stores or less. Similarly, there is a tendency for the larger investors (by value) to opt for turnover lease agreements with their tenants (Figure 6.9).

These figures would suggest that turnover leases are widespread, but this is not necessarily the case. Turnover leases constitute only a small proportion of the portfolios of both retailers and investors (see Figure 6.11). For 70% of the retail-
ers who have turnover leases, such leases only make up 10% or less of their portfolios. Similarly two-thirds of investors using turnover leases only have 10% or less of their retail portfolio let on turnover leases.

The basis of 70% of the turnover lease agreements used by the responding investors was a fixed base rent plus an additional variable amount based on the turnover level of the unit. However, for the retailers renting space on turnover leases, 49% were on fixed base rent plus turnover basis, while 36% were on a higher of base rent or turnover basis (see Figure 6.10).

There was a view amongst both retailers and investors/developers that turnover leases could become more common despite their relative rarity at the moment. However, the current basis needs to evolve into a system that more fairly reflects the risks to landlords and tenants, in particular the fact that the covenant strength of the trader, exhibited through ability to generate cash flow, underpins the capital value of the premises.

‘I can see more uncertainty in the future and a need for owners to be more understanding of occupiers’ needs – a desire to share risk and reward and work to mutual advantage. A vehicle for doing that is a turnover rent. The key is to properly evaluate how that risk is going to be shared. Because at the moment the benefit is on the side of the landlord, even with a turnover rent – even though there might be some varying amount, there’s still a cap and that cap can be very high …So it’s all about managing the cash flow. If you’re managing cash flow to maximise that cash flow, the capital value will follow automatically. But what that capital value will be reflective of will be the covenant strength of the trading company…’

Investor

‘I think there is a growing recognition of turnover. I think the problem historically of turnover has been most turnover leases have been a base rent which is virtually a market rent anyway with turnover top-up. Typically a discount of 10-20% on base rent with a turnover top-up. …To a tenant that means the landlord is really having it both ways. There has been very little literal experience of a true turnover rent….and that’s why there’s been a growing interest in it. It promotes partnership, but our own experience is fairly limited’

Retailer

**Future space requirements over next three years**

Retailers were asked what their real estate requirements would be over the next three years. As Figure 6.12 shows, 65% of retailers see a need to increase their retailing space over this time scale and 27% are happy to stay the same. The proportions are almost reversed for distribution and office space with 62% and 65% respectively saying they anticipate no change in the space requirements for these functions. This is in contrast to recent surveys of retailer demand (e.g. CBI/GVA Grimley, FOCUS and RICS) which show a bearish view, with retailers holding or scaling back their expansion plans over the short term. The difference may be
Larger retailers are looking to expand distribution space...

Retailers with leasehold space are set to expand...

due to a combination of the varying timeframes adopted and sample compositions.

It was those retailers with a medium sized portfolio that favoured expanding their retail space (see Table 6.4). Increases in distribution space were most favoured by retailers with the largest store networks. Only around one-third of all retailers with more than 16 stores saw a need to increase their amount of office space.

If the same data is analysed according to the proportion of space occupied under freehold ownership, retailers with the least proportion of freehold space tend to anticipate an expansion of their retail space (Table 6.5). For distribution and office space a similar pattern is not apparent.

Some 60% of retailers said they would accommodate any retail space increases by increasing the number of stores. In addition 6% said they would increase store size. In terms of distribution space those who plan to increase their space prefer to do so by having more distribution centres or using their existing stores (Figure 6.13).

Interviewees indicated several ways in which ecommerce might affect their future property strategy, for example through:

- allowing them to take smaller units;
- changing physical store layouts;
- freeing up space in existing stores, allowing diversification into other product groups;
- accentuating the consolidation of retail locations, including closing stores that have become marginal in their contribution to profit; and,
- the opportunity to save cost through a reduction in stock exposure and operational space, including distribution and warehousing, as the result of B2B activity and just-in-time delivery.

Table 6.4 Proportion of retailers in each size category anticipating an expansion of their space requirements

<table>
<thead>
<tr>
<th>NUMBER OF STORES</th>
<th>RETAIL</th>
<th>DISTRIBUTION</th>
<th>OFFICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 or less</td>
<td>48%</td>
<td>29%</td>
<td>14%</td>
</tr>
<tr>
<td>6 to 15</td>
<td>68%</td>
<td>30%</td>
<td>22%</td>
</tr>
<tr>
<td>16 to 49</td>
<td>85%</td>
<td>35%</td>
<td>35%</td>
</tr>
<tr>
<td>50 or more</td>
<td>73%</td>
<td>45%</td>
<td>36%</td>
</tr>
</tbody>
</table>

Table 6.5 Proportion of retailers anticipating an expansion of their space requirements, by freehold ownership levels

<table>
<thead>
<tr>
<th>% FREEHOLD</th>
<th>RETAIL</th>
<th>DISTRIBUTION</th>
<th>OFFICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>No freehold</td>
<td>68%</td>
<td>34%</td>
<td>29%</td>
</tr>
<tr>
<td>1 to 25%</td>
<td>78%</td>
<td>34%</td>
<td>26%</td>
</tr>
<tr>
<td>26 to 50%</td>
<td>64%</td>
<td>47%</td>
<td>22%</td>
</tr>
<tr>
<td>51 to 75%</td>
<td>36%</td>
<td>17%</td>
<td>25%</td>
</tr>
<tr>
<td>76 to 100%</td>
<td>52%</td>
<td>32%</td>
<td>25%</td>
</tr>
</tbody>
</table>
‘Our strategy now is really to develop the e-commerce side of the business so we have a robust e-commerce function and from that that will drive our property strategy, because it will allow us to take smaller units. It will allow us to diversify into other product groups and allow us to use the space in the stores that we’ve got, which are quite large, for other things. … I think the data we get back from our Internet business, the customer data and their shopping habit data, will help us in the way we fit our stores… It could be that people who buy certain products also like to buy other products, which are not located close by. So we’re going to start feeding that information back into our category management systems and have a better store environment.’

Retailer

‘…We actually trade from 1400 town centres. And we will continue to trade from those town centres. We do have a strategy that might tweak some of those locations as we move to what we call edge of town – it’s not greenfield development, but it’s moving our business into those, if you like, off centre primary retail locations where new markets have been created’.

Retailer

‘…there will be some locations which will become affected by this and we’ll have to look at that. We’re not beyond closing down stores and that is perhaps something we haven’t done aggressively enough over the years…perhaps not looking at stores that don’t contribute more than they should…’

Retailer

‘… our appetite for space is …reducing because we have a requirement for less sales area and also a need for less operational space, driven by business to business commerce. …given the reality that we have to remove cost, then the relationship we have with suppliers and manufacturers has to be as slick as possible. So it’s all about just in time deliveries’.

Retailer

‘ If we can get our supply chain, fulfilment chain right, we should be able to deliver pretty much everything that’s available within the UK within 24 hours. …So our stock exposure should come down quite substantially’.

Retailer

**Occupation costs**

Retailers were asked about how they anticipated their costs of occupation would move during the short (1-2 years) to medium (5 years) term.

Figure 6.14 shows the pattern of responses, with 79% of retailers expecting an increase over the next 5 years and 66% expecting an increase over the next 1 to 2 years. Most of those retailers who anticipated their costs would stay the same over the shorter timeframe opted for an increase over the longer term. Those who saw a reduction in costs in the short term held the same views for the longer term.
Retailers were asked whether they would consider restructuring and refinancing their UK real estate portfolio over the next five years. Due to their larger property portfolio this part of the analysis only deals with the largest retailers with 50 stores or more. Just under one-third (32%) said they would consider such a move, 68% said they would not.

A clear set of drivers was picked out by these retailers as being important within their decision making (see Figure 6.15). The following factors were all seen as being important:

- The need for flexibility within the real estate portfolio, allowing speedy changes as necessary (80% considered this to be important or very important);
- Property market dynamics (85% consider this to be important or very important);
- Financial and cost factors – allowing the hidden value locked into property to be realised (79% consider this to be important or very important); and
- A competitive environment – allowing businesses the ability to win new business (86% consider this to be important or very important).

In view of the fears expressed by many observers, it is interesting to see that retailers adopt a fairly sanguine view when it comes to the threat of the Internet. The response to the issue of the Internet creating less need for space was dismissed as being not important (80% of large retailers responded this way). This ties in with the bullish response to future space requirements already mentioned.

In addition to the drivers of real estate restructuring and outsourcing, retailers were also asked how they would go about this process. In particular they were asked which advanced vehicles and lease structures would become important. Figure 6.16 shows the pattern of responses by large retailers. Almost half (46%) said sale and leasebacks would be important. This is probably to be expected, due to the widespread familiarity of sale and leaseback deals. 21% said spin-offs and divestments would be important and the same proportion saw securitisation as being important in the future. Wired leases did...
not attract a huge response and this would follow the uncertainties that all respondents (including investors, advisers and retailers) gave to a general question about wired leases.

6.1.5 Are etailers’ property requirements different from conventional retailers’?
Of the six pure-play etails, five gave some details of the space they occupy, but only two gave full details. The etailers occupied a variety of space including call centre, and business units. Three of the companies either leased all or practically all of their occupied space, while two owned the freehold of all their space. Two of the leaseholders desired an average lease length across their portfolio of 6 to 10 years, but only one company was currently doing so – the other had leases with terms in excess of 15 years.

Three of the etailers said they wanted to increase their retail space, by opening physical stores, but maintaining their office and distribution space at existing levels. The remainder saw no need to develop a physical retail arm, but were considering expanding their distribution and/or office space. Compared to retailers, more emphasis is placed on the ‘back office’ space, i.e. that used for storing stock and administration. Due to the small response from etailers it is difficult to draw conclusions from these results, but it appears these firms are looking to expand the physical space they occupy, albeit based on different business models.

The idea of ‘reverse convergence’ was highlighted by one retailer:

> Part of the process of delivery and the recognition for actually interfacing with your customer is to actually open a retail presence. One of the Internet banks is now looking at opening banks in-town centres. But contrast that with conventional banking where we’ve seen two banks close on the high street every working day for the past five years and another 3,500 planned to close. So at one end of the sale you’ve got this major clear out, but then you’ve got the cherries, the opportunities of new products and new services coming in, but one won’t replace the other. But there will be opportunities to mix and match …’

In terms of costs of occupation, all etailers (who expressed an opinion) felt that costs would increase over the next 1 to 2 years and over the next 5 years. These views fit in with the majority viewpoint expressed by conventional retailers, where increased costs of occupation are a particular concern for sectors with low net margins.

6.2 How and when will ecommerce impact on retail property?
6.2.1 Values, yields and returns over next 5 years
All respondents were asked about how the Internet and ecommerce would impact upon key property investment indicators such as yields, rental and capital values, and total returns over the next 5 years. The responses from each group were very similar and followed the overall mean responses, with the exception of investment advisers who tended to judge the risk levels as slightly higher than other groups.

Almost half of all respondents rated each indicator as being at a low risk from ecommerce. Investment advisers tended to see the indicators to be at medium to high risk, while retailers either viewed there to be a low risk or no risk.

The common view was that rental and capital values would fall because of ecommerce, as would total returns. However, overall opinion was more divided for yields: 41% believed that yields would fall, and 36% thought yields would increase, with 23% saying ‘no change’. It
may be that many of the retailers who answered this question did not fully understand the concept of yields and therefore responded inappropriately. For example, retailers have yields falling in similar proportions to responses for values and returns, while the majority of investors, developers and surveyors thought yields would increase in the future.

As Figure 6.17 shows, respondents thought rental values, yields, capital values and returns were mainly at low to medium risk. The differences between response groups is shown more clearly in Figure 6.18. This shows that retailers were more likely than the property industry to...
consider these factors to be at no risk, and a greater number of retailers also considered all factors except rentals to be at high risk. This suggests a misunderstanding of property performance measures by the retailer group.

Generally returns, capital and rental values are expected to fall and yields rise, as shown by the bottom part of Figure 6.18. However, a greater proportion of property industry respondents believed this, perhaps reflecting their greater knowledge of property factors. One investor suggested the impact on rents would be limited and that suggested the impact on yields could be around 0.5% – indeed adjustments were already being made:

‘There still some real rental growth to come through – 1% in real terms over the next 5 years. But without ecommerce it might have been 1.25% real. It’s that sort of margin. That’s our best estimate to what it has done to rental growth and we would factor that into our pricing models that way. The risk around it is you only put in 0.25% diminution in rental growth, when actually it’s much more, say 0.75%.

… For us, it has increased acceptable yield levels by about 40 basis points. … It’s not a ‘no’ signal to buying retail – you just have to buy it at a slightly different price’.

Investor

6.2.2 When will ecommerce impact on UK retail real estate?

Respondents were asked to judge how long it would take before an impact on UK retail property values would be felt.

Although the responses were wide ranging, more than 45% of respondents considered that an impact would be felt at some stage within the next 5 years (Figure 6.19). Retailers, investors and developers tend to see an impact in the longer term, with 56% saying the impact would be in five years’ time or more. This compares to 40% of investment advisers. However, two investors suggested that an impact had already been felt.

Even if there is a risk from ecommerce, some types of retail property are likely to be more at risk than others. Figure 6.20 shows a risk profile for different property types as suggested by respondents. The mean response for all respondents is given and is based on a scale of 0 to 3, where 0 indicates no risk, and 3 indicates high risk. The data has not been disaggregated by respondent group due to the similarity of replies from each group.

Banks and travel agents’ premises are seen to be most at risk, scoring very high on the scale. This follows the argument that these enterprises can be easily transferred onto the Internet and the need for a physical presence is not always necessary. However, many pure-play Internet banks have been considering the development of a physical presence as a means of building trust and loyalty amongst their customers, e.g. Egg (Cap Gemini Ernst & Young, 2000).

At the other end of the spectrum, prime standard shops, large city centre shopping centres and out-of-town regional shopping centres were seen as being less at risk.
The mean risk to property types was rated between low and medium. Table 6.6 shows the pattern of answers and gives the proportion of respondents who felt that a particular product/location combination was most at risk. For clarity the investors and investment advisers have been combined into a single ‘property industry’ group.

For all respondents comparison shopping was seen to be more ‘at risk’ than other categories, particularly in secondary locations. This distinction is less prominent for retailers, but is clear for respondents in the property industry. Investors and developers see niche retailing to be the least risky of the sectors, but convenience retailing is viewed as being ‘safe’ by all respondents. There is also a slight tendency for large cities to be seen as less at risk than other locations, particularly by those in the property industry.

There were also slight differences between related pitches: for example:

- prime high-street stores were judged to be at less risk than secondary pitches; and
- large city centre shopping centres and regional out-of-town centres were seen to be at less risk than secondary city centre shopping centres.

There was a strong feeling that rumours of the death of the high street had been exaggerated. Interviewees anticipated there would be:

- polarisation within towns and between towns;
- potentially a contraction of ‘central business districts’ (CBD);
- prime shops would continue to prosper, but care was needed because average figures could be misleading; and,
- a need for closer scrutiny of planning policies as some areas decline.

‘The threats I think are to certain retail locations that do not have the ingredients that will attract shoppers. It doesn’t mean to say it’ll be the death of the high street. Prime shopping will continue to flourish. The larger town centres will continue to flourish – provided

<table>
<thead>
<tr>
<th>Table 6.6 Products and locations perceived to be most at risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RETAILERS</strong></td>
</tr>
<tr>
<td>NICHE</td>
</tr>
<tr>
<td>Big Cities</td>
</tr>
<tr>
<td>Medium-sized towns</td>
</tr>
<tr>
<td>Small rural towns</td>
</tr>
<tr>
<td>Small metropolitan towns</td>
</tr>
</tbody>
</table>
there’s other social interactive reasons for going there and you’ve got choice and they remain accessible. Where retail will come under threat is the smaller trading locations where retail could be truncated into providing a top up convenience service.’

Retailer

‘In terms of macro-locations … it certainly isn’t Armageddon for any area, but I think locations that offer more selection and more of a experience – cathedral cities [and] the major city centres that offer an extensive range of goods and a better social experience, will be safer. … And I was thinking about isolated communities. If you can get onto the Internet and get a very large range of goods … maybe some of the smaller, isolated towns might suffer.’

Investor / developer

The high street is still vibrant: why? It’s adapted. There’s a lot more leisure involvement … I’m actually running a market in a shopping centre. The problem comes with the secondary streets leading to the high street and at the opposite end of the high street which can’t carry on the sort of marketing and promotion that a covered shopping centre can do. ‘

Investor / developer

‘… as the net aggregate demand for goods to be bought in traditional units drops, then that will have an effect on rents ultimately. And those operating from more secondary locations may be able to move to higher quality locations, because they can get hold of them for an equivalent price level. So you might well find the CBD [Central Business District] area contracting a bit more because of this.’

‘… you will find a consolidation in the area around the well-managed shopping centre. They will go up and the others will come down and the average figure is misleading.’

Investor developer

‘… there is a process of shake out going on anyway in the market place. There’s probably too much retail space around. Very many towns of different rankings will succeed… major cities will get stronger and major regional shopping centres including out-of-town centres. Those will inevitably strengthen and more marginal towns will become more marginalised and they have to look to different sorts of retail offer…’

Retailer

‘Where retail will come under threat is the smaller trading locations where retail could be truncated into providing a top up convenience service. And the problem there is that most planning policies still say we need to protect that [town] centre and ring fence it in the hope of attracting investment so that it will grow. Well I can see that happening in every location. So what we need are policies to manage that change and a recognition perhaps that the planning process should accept that there are now more retail locations out-of-town than in-town centres’

Retailer

6.3 What is the likely future path of ecommerce in retail?

One way for retailers and shopping centre developers to combat potential threats from the Internet (and other competition) is to enhance the entertainment value of shopping, both in store, within centres and on high streets. Most respondents agreed (82%) that this was neces-
Polarisation of prime and secondary retailing was also seen to be an important trend for future years with 72% either agreeing or agreeing strongly that this would happen. There was also further consensus that physical retailing, and those involved, would have to change. In particular there was agreement (63%) that shopping centres would have to integrate the Internet with conventional retailing channels.

In relation to wired leases and B2B efficiencies, the questionnaire survey did not produce any clear-cut majority view amongst respondents on these issues. Attitudes to B2B might be explained from the interview and focus group findings, in that B2B ecommerce was not currently a feature of most retail businesses but was expected to become more important. The future benefits of B2B were expected to come from:

- driving efficiencies in the supply chain;
- creating transparency of information;
- tracking stock and shortening turnover time;
- reducing procurement costs; and,
- facilitating information flows between landlords and retail occupiers, enabling landlords to improve the attractiveness of retail centres and hence the value of property assets.

‘Two areas will help to bolster retail. The first is with efficiencies within the supply chain and also transparency of information flows. It will open up more dynamic pricing models, where suppliers can tender, although this will entail a major breaking down of current covenants in supply chains. There is also a technology barrier. B2B also allows retailers to provide a faster service to their consumers…web enabling ability to track stock shortens the turnover time.’

Investor / developer
‘Certainly this business is focusing on this especially where sales are expected to be flat. With pressure on wage costs and property costs, and they’re the two drivers of costs in the retail business, the only place to go to improve margins is to lower the procurement cost and we’re looking at that...’

Retailer

‘... there is a lot of pressure on our margins. So clearly we’ve got to look to the other end to get some benefits there by cutting costs. The days are over when you can just start screwing suppliers – they’re not prepared to accept that. You’ve got to look at something which benefits both suppliers and the retailers by being efficient.’

Retailer

‘[For the investor] the value proposition of anything to do with ecommerce is to maximise the value of the asset to the asset owner. ...In simple terms it comes down to two things: increasing the attractiveness of the asset for the user (i.e. shopper and tenant) and also using ecommerce to raise the efficiency of the asset.’

‘If we are looking for retailers to register their profile with us, and who they are and what their preferences are, then that gives us a whole source of intelligence that we didn’t have before. That translates into what we offer in the centre physically but also what we can offer to them for information and marketing.’

Investor developer

Other future changes anticipated by interviewees included:

- on the technology front:
  - the increasing importance of Digital TV – putting ecommerce into people’s homes in an accessible form;
  - increasing use of mobile phone commerce for certain products, for example sourcing materials to site; and,
  - a trend for retailers to offer multichannel shopping, as ‘value for time’ becomes increasingly important relative to ‘value for cost’ for the consumer.
- the increasing importance of ‘brand’ and the opportunity to promote existing brands at relatively low cost; and,
- greater use of kiosks and interactive services in-store.

‘Digital TV will dominate. We’ve got an aged-up population and we’ve got cashed-up grannies who have a phobia with PCs, but have TV as an integral part of their life. Also they are not generally as mobile so digital TV will be key in this sector. But there will a vast amazing range of devices in a multichannel environment.’

Investor / developer

‘But certainly digital TV, where we’re actually putting ecommerce into people’s homes in a format that they’re comfortable with – TVs, will certainly be the catalyst I think to move the industry as whole forward. ... when we’ve had conversations with our customers, they say they would never go on line. And what they’re really saying when you dig down is they...’
would never buy a PC. However they would be happy if they could sit in front of their TV with their keyboard and do all that kind of stuff.’

Retailer

‘Mobile: we’re doing lots of trials with mobile. It’s going to be useful for certain products. It’s hard to see people using their phones to buy major consumer electricals. But if it were top-up stuff for say on a building site, where you find you’ve run out of a certain product. Because builders use their mobile phones there may definitely be a route there for ordering straight from B&Q or Screwfix with delivery to site.’

Retailer

‘I think there will be two types of retailers…the high branded value propositions (e.g. Gap and Nikes), the brands people adopt as part of their lifestyle….and the value for cost retailers (eg Matalan, New Look) will be successful. All will operate off a multichannel base though. They will need to have every access point covered… because value for time is just as important as value for cost.’

Investor / developer

‘I think catalogue shopping will continue to appeal. I think some retailers have got it relatively right: Next, Argos for example… That will be an increasing force and that’s really about convenience. I think the ecommerce strand will run alongside that together with conventional shopping. So there will be three major channels.’

Retailer

‘I think the brand name of a company is going to be increasingly important … name awareness will be important because people have to know what you stand for…”

Retailer

‘One thing that strikes me most is the ability to create a brand at a relatively low cost. For example, we spent under a million pounds on marketing this business in three years, and we are perceived to be the biggest European online … brand [in our sector] which is phenomenal. If you look at Iceland, for example, spent fifteen million pounds changing their store fronts from Iceland to Iceland.co.uk…”

Retailer

‘We’ve always prided ourselves on being range specialists, which for a business model is quite difficult, because a lot of stock we’re carrying is slow moving. …It’s there for brand reasons. It’s there to add a differential from some of the smaller retailers. In the future it’ll certainly allow us to take smaller units, because by putting in kiosks and interactives through the stores, we won’t need to carry that range.’

Retailer

6.4 The future for retailers

Interviewees identified the future success of retailers as being dependent on:

- the type of product being offered;
- developing economies of scale; and,
- building the brand.
Pure-play etailing was judged less likely to succeed for complex products or low margin, low volume products, because of the greater risk that the required level of investment would not generate sufficient return. The future was therefore more likely to be characterised by development of the multichannel approach, as evidenced by alliances currently being formed between pure-play etailers and those with a high street presence.

*I think they’re going to be more focused businesses. I think that it’s in a sense like a high street shop, that a shop that’s selling one type of product can more easily become a destination store, where you actively go there when you want to buy that product. … I think it’s actually the more complicated product areas that are not going to do so well and that’s certainly to my mind where etailers are struggling at the moment. They haven’t actually got that viable a product offer.*

Retailer

‘It really depends on the sector they are in and the margins that are available in those sectors. Because etailing as a start-up’s not cheap and a lot of the maintenance is obviously quite expensive as well. So if you’ve got the volume or the margin then it can be successful. From our point of view, from the entertainment, it would be difficult for a pure-play to be successful because it’s low margin and the volumes aren’t really there and the ticket price is quite low. So it’s difficult to actually get the physical volumes through to make it viable …’

Retailer

*I think the more it goes, the more evidence there is that it is very difficult to do it just online. … For me there is a trade-off between how much you have to pay in advertising to keep in people’s minds and how much you have to pay in rent. I haven’t worked out in my mind exactly how that works. You don’t very easily get passing custom so you’ve just got to keep yourself in everybody’s face all the time.*

Retailer

‘In my job I see lot of business plans and when you look at the numbers, it’s just very hard to see them making a profit. You do need the economies of scale you get from being part of a bigger business. … A [well known] brand … has gone transactional online. Its done significant sales from a standing start. Had that been a pure-play it’s Christmas sales would have been next to nothing because they’d have been spending all their time and money brand building.’

‘They’re going to have to get a physical presence, or they are going to have to come into alliances with physical retailers. And I think that’s what you’re seeing.’

Retailer
Key Points

- **Cyberton has a high degree of Internet penetration.** Some 57% of respondents have Internet access at home, and 72% have access at home and/or work. This compares with CACI figures of 48% of people in Cyberton’s retail catchment having home Internet access.

- **There are signs of a digital divide in Cyberton.** Internet use and online shopping is concentrated amongst 15 to 19 year olds and 35 to 44 year olds. Households made up of highly skilled individuals in managerial positions (roughly social grades ABC1) also dominate the online market.

- **Of those with Internet access some 39% have purchased goods online and 45% have researched goods and compared prices over the Internet.** 45% of Internet users have not used the Internet for shopping or related activities.

- **Some 26% of Cyberton shoppers had purchased goods online over the previous week or month** (September/October 2000).

- **Online purchases were often most frequent in smaller sector, specialist product categories such as books, music and travel services rather than the bigger sectors.** For instance, 37% bought women’s clothing in the town and 5% bought online and 2% of respondents bought travel services in the town centre, but 20% bought travel online.

- **Cannibalisation of town centre purchases is a potential threat in Cyberton.** Two-thirds of online shoppers said their online purchases had replaced some of the town centre purchases.

- **Popular online products are also the most likely to replace town centre purchases.** Some 33% of shoppers who made online music and video purchases would otherwise have made them in Cyberton’s music stores, although we did not ask what level of online spend this comprised. Similarly 20% of shoppers who made online holiday and travel transactions replaced a visit to one of the town’s travel agencies. The proportions of replacement sales are much lower for other products although some 13% of shoppers said online electricals had replaced a town centre purchase.

- **Convenience and price were the most important reasons for choosing to shop online instead of the town centre.**

**7.1 What is the level of Internet access in Cyberton?**

As part of our investigation into the effects of ecommerce, consumers in Cyberton (a town in the South East of England) were asked about their activities on the Internet and the frequency of their online purchases.

Some 72% (339) of all shoppers interviewed for the survey have some form of direct access to the Internet, either at home or at their place of work. However, this hides a more detailed pattern of web access.
Figure 7.1 shows that 28% had no Internet access whatsoever (the unshaded circle). The shaded circles represent those who did have Internet access and are split into those with home access (57%) and those with work access (42%). Inevitably many will have access in both their home and work environments and this is reflected by the darker shaded overlap area constituting 27% of those interviewed.

Detailed statistics from CACI for Internet access at home tallies well with our survey findings. CACI suggest that 48% of Cyberton’s catchment population have access to the Internet at home. Our survey was conducted some 5 months after the CACI data was published, therefore accounting for the slightly higher figure of 57% coming from the survey. However, compared to CACI data for Internet use in the postal sectors of our sample, our survey findings are much higher. As Figure 7.1 demonstrates, CACI estimate that 32% of our sample will be online, but this is much lower than responses suggest.

7.1.1 Is there a digital divide in Cyberton?
Research by Booz Allen (2000) has shown there is a digital divide amongst the UK population. This is reflected amongst our shopper sample, but unlike the Booz Allen data the relative proportion of Internet users in each of the town’s age categories is higher than those found nationally. Around three-quarters of 15 to 19 year olds have Internet access at home, as do 65% of 35 to 54 year olds have Internet access at home, as do 65% of 35 to 54 year olds. Similarly the higher levels in the Standard Occupational Classification have greater access to the Internet at home with 77% of managers and senior officials having access at home. This declines to 38% of skilled trade workers having home access. In addition the three individuals interviewed who were unemployed had no home access to the Internet.

Although there were not equal proportions of men and women interviewed (39% men; 61% women) the proportions who had home Internet access were almost equal (60% men; 57% women).

7.1.2 How do people use the Internet for shopping in Cyberton?
Of those respondents who have Internet access 45% do not use it for any form of shopping related activity (Table 7.1). 26% use the
Internet to do research about products and 19% use it to compare prices. 39% of Internet users have purchased goods online. This compares reasonably well with CACI’s data which suggests that 17.9% of Cyberton’s catchment population are frequent online shoppers, and 30.1% are infrequent online shoppers – a total of 48%.

Respondents were then asked if they had conducted an online purchase at any time within the preceding twelve months. The sample responded as follows:

- 36% of all shoppers said that somebody in their household had shopped online during the past year;
- 26% of all shoppers said an online purchase had been made during the past month; and
- 9% of all shoppers had made an online purchase during the past week.

These are all cumulative figures. The annual figure includes the shoppers who said they had bought in the last month, and this figure in turn includes those who had bought online in the last week.

### 7.1.3 What sort of goods do people buy online in Cyberton?

The most popular products bought online were music and videos, and books, magazines and newspapers (Table 7.2). Both product types had been purchased by 37% of those who claimed to shop online. Other popular goods were travel services, computer software and electricals. Large comparison goods and clothing were not popular online buys, and only 15 people said they used the Internet for online banking.

These purchasing patterns contrast sharply with the items purchased by the shoppers in town (Table 7.2). Physical retailing was dominated by ‘tactile’ and ‘experience’ shopping, such as clothing, gifts and household goods whereas online retailing was favoured for ‘intangible’ and ‘non-tactile’ goods such as CDs, DVDs and books. Music and books did account for a substantial proportion of sales in town on the survey days (15% and 14% respectively), but it was

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Some respondents did not provide consistent answers throughout the survey. Therefore the figure for the proportion of online purchasers in Table 7.1 is not the same as figures for online purchases in the last year.

CACI demographic data is quoted for the adult population aged 18 and over who live in the Cyberton retail catchment area.
other goods that displayed the greatest contrast between offline and online sales patterns. Computer software and electrical goods ranked low on the list of offline purchases, but very high on the online list. However, the biggest contrast was seen with travel services, accounting for 20% of online sales, but only 2% of in-town sales.

About half of the online shoppers said they had used the Internet for its convenience and 40% said that price had been a contributory factor in their choice of online shopping (see Figure 7.3). The results support the view that people are shopping on the Internet for convenience, time saving and because certain items are cheaper than in high-street stores.
7.1.4 Is Cyberton town centre under threat from ecommerce?

Shoppers were asked about their shopping habits on the day of the survey and in more general terms. Respondents were asked to identify what items they had bought or were intending to buy during their visit.

The most popular purchases were clothing and groceries, with women’s clothing being purchased by nearly 37% of all respondents (Table 7.2 and Figure 7.4). Gifts were also rated highly as a popular product type perhaps signifying some early Christmas present purchases. The least popular goods and services were computer software (4% of respondents), sports goods (3%), travel (2%) and furniture (2%). Furniture, sports goods and computer software are likely rated low due to the lack of appropriate stores in the town centre. Many of Cyberton’s shops trading in these sectors are located within edge-of-town and out-of-town retail parks.

A real threat for conventional retailing is if consumers are buying goods online instead of going to physical stores. Just under two-thirds of the online shoppers said that some or all of their online purchases in the last year had replaced a purchase that they would have otherwise been made in the town centre. This represents 23% of all the people interviewed. Table 7.3 and Figure 7.5 show this information by product type. However, our survey did not include any question on how much total expenditure would be replaced so it is not possible to arrive at a specific sales diversion figure. This result compares favourably with research by Ernst & Young (2001). Their survey of consumers world-wide showed that 68% of UK online consumers had made a purchase online that would have replaced a sale in a traditional store or catalogue. Interestingly this was the highest such proportion for all the countries surveyed including the UK (59%), Canada (55%), France (51%) and the Netherlands (61%).

Popular online products are also the most likely to replace town centre purchases. Some 33% of shoppers who made online music and video purchases would otherwise have made them in Cyberton’s music stores. Similarly 20% of shoppers who made online holiday and travel transactions replaced a visit to one of the town’s travel agencies. The proportions of replacement sales are much lower for other products (see Table 7.3) and only 9% of all town centre shoppers had purchased online in the week up to the survey days. Therefore the frequency of these replacement sales on many products will be quite low.

Table 7.3 Goods purchased online replacing town centre purchases

<table>
<thead>
<tr>
<th>Products</th>
<th>% OF ONLINE SHOPPERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ALL GOODS PURCHASED ONLINE WITHIN THE LAST 12 MONTHS</td>
</tr>
<tr>
<td>Music and videos</td>
<td>37.2%</td>
</tr>
<tr>
<td>Books, magazines and newspapers</td>
<td>36.6%</td>
</tr>
<tr>
<td>Travel</td>
<td>23.3%</td>
</tr>
<tr>
<td>Electricals (incl. mobile phones)</td>
<td>10.5%</td>
</tr>
<tr>
<td>Computer software</td>
<td>14.5%</td>
</tr>
<tr>
<td>Other goods</td>
<td>9.3%</td>
</tr>
<tr>
<td>Bank or building society</td>
<td>8.7%</td>
</tr>
<tr>
<td>Women’s clothing</td>
<td>5.2%</td>
</tr>
<tr>
<td>Gifts</td>
<td>5.2%</td>
</tr>
<tr>
<td>Food / Groceries</td>
<td>9.3%</td>
</tr>
<tr>
<td>Men’s clothing</td>
<td>5.2%</td>
</tr>
<tr>
<td>Other household goods</td>
<td>4.1%</td>
</tr>
<tr>
<td>Sports goods</td>
<td>1.2%</td>
</tr>
<tr>
<td>Toys</td>
<td>5.8%</td>
</tr>
<tr>
<td>Health and beauty</td>
<td>0.6%</td>
</tr>
<tr>
<td>Footwear</td>
<td>1.2%</td>
</tr>
<tr>
<td>Furniture and floor coverings</td>
<td>0.6%</td>
</tr>
<tr>
<td>Children’s clothing</td>
<td>1.2%</td>
</tr>
</tbody>
</table>
Key Points

- Three scenarios were developed nationally in the UK and within Cyberton, a large town in the south east of England with a relatively high degree of Internet access. The scenarios are not intended to be forecasts, but rather to highlight various possibilities which may emerge over the next 5 years.

- The scenarios were 'sluggish', 'growing' and 'rapid', each assuming a different online share of total retail sales by 2005: 2.5%, 5% and 7.5% respectively. The current online share is assumed as 0.6% of total retail sales both nationally and in Cyberton. Each scenario assumes 93.5% overall cannibalisation rate each year to 2005 for online sales but this varies by goods sold. The growing scenario share of 5% online sales is a little higher than the current home shopping share (about 3-4%) nationally.

- Real retail sales (i.e. volume growth of total retail excluding online but including home shopping) are estimated to be 2.8% pa nationally for 2000-2005 and 3.35% pa in Cyberton. Lower growth would be expected to hit both offline and online sales.

- Nationally, and in Cyberton, potential offline sales are expected to be reduced by between 0.4% pa and 1.4% pa depending on the scenario adopted. It might be expected that up to 50% of this diversion could be from home/catalogue sales with the balance diverted from stores, but this is not certain.

- Nationally, annual household spending online is expected to increase from about £30 in 2000 to £238 (sluggish), £489 (growing), or £783 (rapid) in 2005. In comparison, and with higher annual household expenditure generally, Cyberton is expected to have higher annual online household spend figures: £284, £583 and £898 per household in each respective scenario rising from a figure of £60 in 2000.

- Clothing and footwear is expected to have the highest online growth rates nationally and in Cyberton in the growing scenario, but its online share in 2005 nationally may still only be 4% in the 'growing' scenario. This reflects the likelihood of high diversions from home/catalogue shopping. Other categories of goods would have to grow at rates of between 26% pa and 70% pa to reach their respective, forecast online shares in the 'growing' scenario by 2005.

- There is an inverse relationship between UK online sales for particular goods and the same good's share of overall retail sales. Goods which are an important part of UK total retail sales are under relatively less threat (i.e. groceries) from the online channel than those which are a less important part of retail spend (i.e. music/video).

- In Cyberton we calculate that some 16.5% of floorspace is currently under threat from ecommerce and this includes a high proportion of financial services and travel. Oversupply may be a future factor to consider in a town where a 10% retail vacancy rate is not uncommon.
### Key Points (continued)

- **In the ‘growing’ scenario, a real rental growth rate reduction of between just under 0.5% pa and 1% pa for 2000-2005 could be expected both nationally and in Cyberton. A lower online share (‘sluggish’) would result in rental growth reduction of about between 0.2% pa and 0.4% pa and more rapid growth in a 0.7% pa to 1.4% pa reduction. The higher figure in each scenario assumes all sales diversions come from stores, the lower figure that 50% come from store sales diversions (with the balance, 50%, diverted from home/catalogue shopping).**

- **The Cyberton shopping centre case study shows how important the balance of floorspace in a centre can be in determining future rental growth patterns. Getting the retail mix and the turnover basis right are both important in Internet-proofing shopping centre performance. In the case study centre rental losses are likely to be negligible: 0.09% pa or 0.33% pa depending on the level of sales diversions from stores.**

### 8.1 Background

Section 1 of this report showed that there are a variety of views on the size of the future online ecommerce market in retail. To help understand better how ecommerce might impact on retail sales in the UK, we developed three scenario-based models for the period 2000-2005.

The three scenarios are shown in Table 8.1 and comprise ‘Sluggish’, ‘Growing’, and ‘Rapid’. All three scenarios are based on the assumption of 0.6% online sales share in 2000 (or £1.24bn) as a percentage of all retail sales. This is rather less than Verdict’s 2000 estimate of 0.7% mainly because we have assumed less optimistic Christmas online sales in 2000 than Verdict’s forecast of treble the 1999 level.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Real Retail Sales Growth (exc. Online) 2000-2005 (%)</th>
<th>Online Share, 2005 (% All Retail Sales)</th>
<th>Online Share 2005</th>
<th>Cannibalised Sales (% Total Online Sales Each Year)</th>
<th>Growth of Internet Access and Propensity to Shop Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sluggish</td>
<td>2.8% pa</td>
<td>2.5%</td>
<td>£6.04bn.</td>
<td>93.5%</td>
<td>Low</td>
</tr>
<tr>
<td>Growing</td>
<td>2.8% pa</td>
<td>5%</td>
<td>£12.4bn.</td>
<td>93.5%</td>
<td>Medium-High</td>
</tr>
<tr>
<td>Rapid</td>
<td>2.8% pa</td>
<td>7.5%</td>
<td>£19.1bn.</td>
<td>93.5%</td>
<td>High</td>
</tr>
</tbody>
</table>

### 8.2 What are the aims of the scenarios?

The scenarios offer differing views of how ecommerce may impact on UK retail over the next 5 years. In particular, they are designed to show:

- How ecommerce might divert potential offline sales to the online channel;
- How this effect may vary across different types of good; and,
- How the potential lost store-based sales may impact on rental growth prospects nationally and locally.

The scenarios are not intended to be precise forecasts but are designed to indicate the possible impact of ecommerce over the period 2000-2005, depending on the assumptions within the scenario adopted.

National scenarios were prepared, and the same scenarios carried over to a local level to our case study, Cyberton. The key inputs to the models are explained in more detail in Appendix B.
8.3 What do the scenarios show?

8.3.1 Retail sales growth impact

The differences between the scenarios are also highlighted in Figure 8.1 and Table 8.2. This summarises the differences in lost offline sales growth rate and the average yearly loss in turnover over the 5 year period. The main points to emerge are:

- The losses in potential offline sales growth are relatively small even in the ‘rapid’ scenario (for example, 1.4% pa for the period 2000-2005).
- Average turnover losses are also relatively small but the rapid scenario has a turnover loss of just over 4% pa.
- In the ‘growing’ scenario, the shift towards an online share of 5% in 2005 would cause offline sales growth to be reduced by 0.88% pa over the period 2000-2005. This is equivalent to an average turnover loss of 2.59% pa over the period 2000-2005, and an equivalent loss of some 4.85% cannibalisation of offline retail sales for each and every store in the UK in 2005.
- The online sales growth rates required to attain the required online shares by 2005 are dramatic. In the ‘growing’ scenario, online sales growth would have to run at 58.5% pa to achieve an online share of 5% by 2005. If this occurred, total retail sales (including online) would grow at 3.74% pa over the same period.
- In the ‘growing’ scenario, the online share of 5% of total sales by 2005 is a little more than the 3-4% of total sales that home shopping currently represents. We have not, however, produced separate diversion figures for the sales that may or may not be diverted from stores and home shopping respectively. Instead, our cannibalisation rate applies to all offline sales. It is also important to appreciate that the potential loss of offline sales includes both store and home-based sales. In categories such as clothing and footwear the diversion from home-based sales to the Internet may well be as important as the diversion from stores. If 50% of all diversions were from home-based sales this would halve the potential loss in sales growth in each scenario for store-based sales to 0.2% pa, 0.44% pa and
0.7% pa in each of the three scenarios. This could happen quite easily, particularly as the size of the current mail order shopping sector (some £7,111m in 1999) bears comparison with the total offline sales diversions in 2005 under the three scenarios (£5,649m, £11,595m and £17,863m respectively – see Figure 8.2).

It is important to appreciate that the scenarios are based on modelling the sales that are diverted to the online channel from offline sales that would have otherwise occurred. Therefore offline sales can still grow (in each scenario at 2.8%pa) but not at the rate they would otherwise have done. Figure 8.3 shows the differences between the three scenarios in absolute terms. This highlights the small amount of incremental sales in each scenario in contrast to the increasing amount of cannibalised sales as the online share increases. The offline share (excluding online sales) remains constant across the scenarios (£205bn in 2000 and £235bn in 2005).

### 8.4 How will household spending be affected by ecommerce?

To put the scenarios into context we also examined how much online spend per UK household would be created by each scenario. Currently (in 2000) we calculate that the annual average household spend on online sales for all UK households is about £50 per household per annum. However, the amount would vary considerably by 2005 depending on the scenario adopted:

- In 2005 the Growing Scenario produces an equivalent figure of £489 per household per annum (Figure 8.4), which is equivalent to about 20% of the amount spent per annum on leisure goods and services by UK households in 1998/99.
- The equivalent UK household spend figures for the sluggish and rapid scenarios are £238 per household per annum and £783 per household per annum respectively.

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<table>
<thead>
<tr>
<th>Scenario</th>
<th>Average Spend (£) Per UK Household P.A.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sluggish 2000</td>
<td>200</td>
</tr>
<tr>
<td>Growing 2000</td>
<td>500</td>
</tr>
<tr>
<td>Rapid 2000</td>
<td>800</td>
</tr>
</tbody>
</table>

* This is equivalent to approximately £150 per annum for each UK household currently shopping online.
8.5 What is the impact of ecommerce in different product ranges?

To add further detail to the overall scenarios we examined a range of different goods within the growing scenario.

These goods comprised:

- Grocery
- Clothing/Footwear
- Software
- Music/Video
- Books
- Other goods

We used forecast retail sales growth figures from a range of sources for these individual goods, combined with Verdict’s figures on cannibalised / incremental sales, to produce the overall pattern shown in Figure 8.5.

- In the ‘growing’ scenario, software (11.5% pa), music/video (3.05% pa) and books (2.1% pa) are all expected to suffer bigger than average losses in potential offline sales than other categories of good.

- Interestingly clothing and footwear online sales growth is expected to be rapid (155% pa), heavily fuelled by a diversion from home/catalogue shopping to online. We might therefore expect up to, say, 50% of offline sales to be diverted from home-based sales and 50% from store-based sales. However, the online share of this category in 2005 nationally will still only be 4% in the ‘growing’ scenario.

- Other goods would have to grow at rates of between 26% pa and 70% pa to reach their respective online shares by 2005.

- The average online spend for groceries is likely to be about £195 per annum per household in 2005 which equates to about 5% of all grocery sales in 2005. All other categories under this scenario result in figures of less than £100 per household per annum. The
8 The Future Impact of Ecommerce on UK Sales and Rents

Equivalent in terms of online spend per UK household is shown in Figure 8.6 for the ‘growing’ scenario.

8.6 What is the relationship between online sales share and total sales?
Finally, to show the inverse nature of the relationship between online sales penetration in individual goods categories (excluding financial services and travel) and the relative importance of that same good’s share in overall sales in 2000 and 2005, we constructed the graph shown in Figure 8.7.

This shows that:

- Relatively important items in relation to total retail sales have low online sales penetration and vice versa. For example, groceries are an important part of total retail sales, but their online sales penetration is expected to be low in 2005 (4.9% of total grocery sales).
- Conversely, the less important part of a household’s spending, such as music and video is expected to have a high degree of online sales penetration (20.4%) in 2005.

8.7 How will ecommerce impact on travel and financial services?
We also carried out separate analysis for financial services and travel. Figure 8.8 shows that online travel and financial services are expected to grow at rates of 56% pa and 36% pa respectively. The expected losses of retail sales of 1.6% pa and 3.7% pa are only exceeded in the software (11.5% pa) music/video (3.05% pa) and books (2.11% pa) categories. The equivalent online household spend in 2005 would be £73 per household per annum for travel and £330 per household per annum for financial services.

8.8 What is the impact of ecommerce at a local level?
We also produced forecasts for our case study town, Cyberton. Our shopper surveys found that some 72% of the town’s shoppers were online at work or at home. Appendix B shows our assumptions in more detail. Our main findings were:

- The stronger volume sales growth in Cyberton produced only a slight variation...
in other key retail indicators from the national picture, as shown in Table 8.3.

- Similarly we found little variation by individual goods from the national picture. For example, in the growing scenario in Cyberton, software (11.5%), music/video (3.06%) and books (2.12%) were the biggest losers in terms of lost online sales, with rates very close to the national picture. Clothing and footwear online sales growth is again expected to be rapid at 156% pa in this scenario, reflecting the likely online diversion from home shopping.

- However, Cyberton annual spending levels per household are higher than the national average, and this, coupled with different demographic shifts over the period 2000-2005, produces a higher online annual spend per household figure in Cyberton.

- This is shown in Figure 8.9. Under the growing scenario, for example, Cyberton online annual spend per household in 2000 is £60 compared with £50 in the UK. By 2005 this has risen to £583 compared with £489 nationally.

- The amounts spent online by Cyberton households also varies from the national average. This is shown in Figure 8.10 which indicates that by 2005 Cyberton households under a growing scenario would be spending more online across all categories than the national average. For example, £232 on groceries per household per annum compared with £195 nationally, and £52 on music/video compared with £44 nationally.

### Table 8.3 Comparison of key retail indicators for Cyberton 2000-05, by scenario

<table>
<thead>
<tr>
<th></th>
<th>Sluggish</th>
<th>Growing</th>
<th>Rapid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Share (% All Retail Sales) in 2005</td>
<td>2.5%</td>
<td>5.0%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Retail Sales Growth (% pa) (incl online) 2000-2005</td>
<td>3.74%</td>
<td>4.25%</td>
<td>4.77%</td>
</tr>
<tr>
<td>Online Sales Growth (% pa) 2000-2005</td>
<td>38.02%</td>
<td>59.37%</td>
<td>73.76%</td>
</tr>
<tr>
<td>Retail Sales Growth (excl online) (% pa) 2000-2005</td>
<td>3.35%</td>
<td>3.35%</td>
<td>3.35%</td>
</tr>
<tr>
<td>Reduction in Offline Sales (% pa) 2000-2005</td>
<td>0.37%</td>
<td>0.88%</td>
<td>1.40%</td>
</tr>
<tr>
<td>Average Annual Turnover Lost (2000-2005)</td>
<td>1.08%</td>
<td>2.59%</td>
<td>4.16%</td>
</tr>
<tr>
<td>Cannibalised Offline Sales Per UK Store in 2005 (as % of total offline retail sales per store)</td>
<td>2.39%</td>
<td>4.85%</td>
<td>7.58%</td>
</tr>
</tbody>
</table>

Note: All growth figures are real rates of growth. Reduction in Offline sales includes store and home-based sales.
8.9 What is the potential impact of ecommerce on rents?

8.9.1 Nationally

In the deflationary ‘noughties’ we have adopted a rough and ready relationship of 1:1 for each of our three forecasts. In other words, an increase or decrease in real retail sales of 1% pa is associated with an increase of real standard shop rents of between 1% pa. (see Appendix B)

If we adopt this same relationship of retail sales and rents for the period 2000-2005, the figures shown in Table 8.4 are obtained.

This shows, in the ‘growing scenario’ for example, that a potential loss of between 0.45% and 0.9% pa in rental growth rate would occur given that offline sales loss is 0.88% pa. The lower figure is on the assumption that up to 50% of the reduction in offline sales is from store-based home-based diversions. The higher figure is on the assumption that all diversions would occur from store-based sales.

This should be judged against rents which would still be expected to grow in real terms at up to 2.8% pa, driven by the growth of 2.8% pa in offline sales.

Table 8.4 also shows that the expected rental growth (2.8% pa) in each scenario is the same because retail sales (excluding online sales) are growing at the same rate of 2.8% pa in each scenario. The potential loss in offline sales and rental growth is different in each scenario, however, because the online share varies in 2005.

The above analysis indicates that at most, were there to be rapid ecommerce growth between 2000 and 2005, potential retail rental growth would be reduced by just under 1.5% pa. If ecommerce growth was less rapid, rental growth slowdown in the range of just less than 0.25% pa to less than 1% pa might be expected.

If real retail sales growth (excluding online) was less spectacular, and ‘flatter’, at 1% pa, then potential rental growth loss would be little different from the ranges associated with the 2.8% pa assumption of retail sales growth between 2000 and 2005. However, a 1% pa growth in sales would only leave room for about 1% pa growth in rents. The potential loss in rent to arrive at this figure (e.g. in the growing scenario, a range of 0.45% to 0.9% pa loss) would therefore have a greater proportionate effect than with higher sales growth of a 2.8% pa increase in sales, which would be associated with a 2.8 % pa increase in rents.

However, it should be noted that these figures relate solely to our assessment of the impact of online sales diversion on rents. Rents are also dependent on a number of other factors at a national and local level, which will also tend to impact over the same period. Competing centres, consumer confidence, economic conditions, as well as planning policy and environmental

| Table 8.4 Potential impact of ecommerce on standard shop rents |
|-----------------|-----------------|-----------------|
|                 | SLUGGISH | GROWING | RAPID |
| Online Share (% All Retail Sales) in 2005 | 2.5% | 5% | 7.5% |
| Retail Sales Growth (excl online) % pa 2000-2005 | 2.8% | 2.8% | 2.8% |
| Expected Rental Growth (% pa) 2000-2005 | 2.8% | 2.8% | 2.8% |
| Reduction in Offline Sales (% pa) 2000-2005 (assuming 100% diversion from stores) | 0.37% | 0.88% | 1.4% |
| Reduction in Offline Sales (% pa) 2000-2005 (assuming 50% diversion from stores) | 0.19% | 0.44% | 0.7% |
| Potential Reduction in Retail Rental Growth (% pa) 2000-2005 | 0.2 – 0.4% | 0.45 – 0.9% | 0.7 – 1.4% |

Note: All growth figures are real rates of growth
8.9.2 Cyberton Case Study

Despite the greater real sales growth in Cyberton (3.35% pa between 2000 and 2005) the overall impact on rents is almost identical in Cyberton to the national picture, as shown in Table 8.5. Figure 8.11 summarises the on rents nationally and in Cyberton over the period 2000-2005.

8.9.3 Cyberton: Shopping Centre ‘X’ – Impact of ecommerce on turnover and rents

Our estimates for retail sales growth in Cyberton show that software, music and videos, and books could be the sectors greatest hit by an increase in online shopping amongst the local population. To examine how this may impact upon the local retail property market, these estimates have been applied to the rental data for the town’s primary shopping centre. The centre has a wide mixture of tenants, but there is a strong representation from fashion retailers. Most units are let on turnover leases and are made up of a fixed based rent (reviewable every 5 years) plus a turnover element. The turnover element is only activated when the unit’s annual turnover exceeds a set threshold.

Two ‘scenarios’ are used to measure the size of a potential impact:

- The ‘no ecommerce’ world assumes that there is no further future growth in Internet sales and consequently there is no further cannibalisation of offline sales. Retail sales growth rates therefore continue unhindered.
- The ‘ecommerce world’ is one where Internet sales expand according to our ‘growing’ scenario and offline sales are cannibalised.

Two further assumptions are also used which recognise that some of the sales diversion will not only be from physical stores, but also from traditional mail-order and other forms of non-store retailing. To account for this there are two levels of sales diversion from stores: 50% (with balance from other non-store sales) and 100%.

Department stores and fashion retailers contribute the most to the total turnover generated in the centre. Books, music, software and leisure make up the smallest share (see Figure 8.12). With

Table 8.5 Cyberton: potential impact of ecommerce on standard shop rents

<table>
<thead>
<tr>
<th>SLUGGISH</th>
<th>GROWING</th>
<th>RAPID</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Share (% All Retail Sales) in 2005</td>
<td>2.5%</td>
<td>5%</td>
</tr>
<tr>
<td>Retail Sales Growth (excl online) % pa 2000-2005</td>
<td>3.35%</td>
<td>3.35%</td>
</tr>
<tr>
<td>Expected Rental Growth (% pa) 2000-2005</td>
<td>3.35%</td>
<td>3.35%</td>
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<tr>
<td>Reduction in Offline Sales (% pa) 2000-2005 (assuming 100% diversion from stores)</td>
<td>0.4%</td>
<td>0.88%</td>
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<tr>
<td>Reduction in Offline Sales (% pa) 2000-2005 (assuming 50% diversion from stores)</td>
<td>0.2%</td>
<td>0.44%</td>
</tr>
<tr>
<td>Potential Reduction in Retail Rental Growth (% pa) 2000-2005</td>
<td>0.2 – 0.4%</td>
<td>0.45 – 0.9%</td>
</tr>
</tbody>
</table>

Note: All growth figures are real rates of growth
100% sales diversion the total turnover for the centre in 2004/05 is estimated to be 4.2% less in real terms than it would have been without e commerce because of the growth in online sales.

With 50% sales diversion this difference drops to 2.1%. This hides a more detailed pattern of losses within individual sectors where software, music and books suffer the most. For instance, with 100% sales diversion, revenue for the centre’s music stores is 13.1% less in real terms by 2004/05 because of Internet sales growth; with 50% sales diversion the loss is 7.1%.

These are dampened when revenues are fed through to calculate the rental income of the centre. With 100% sales diversion from stores the total rent roll is some 1.64% less (in real terms) by 2005 due to the loss of turnover related to Internet sales growth (see Figure 8.12). This is equivalent to 0.33% pa loss in rent. The overall difference reduces to 0.46% (or a very negligible 0.09% loss per annum) where there is only 50% sales diversion. This compares with losses in the ‘growing scenario’ in the town as a whole of 0.45% pa or 0.9% pa depending on the level of store diversions.

The turnover data also shows that the sectors making up the smallest share of turnover in the centre contribute the largest share of rental income loss. This is demonstrated in Figure 8.13 by the lighter blocks representing the music, book, and software retailers. With 100% sales diversion the loss of rental income contributed by fashion stores, leisure, and other retailers is only 0.27% in total (or 0.08% pa) for the period 2000-2005 in real terms, compared to 1.64% (0.05% pa) for the whole centre.

This substantial component of loss from books, music, and software can be explained by the substantial growth in Internet sales that we have used for the town in these categories. Our figures show, for example, that music and video sales are reduced by just over 3% pa in real terms because of diversion online.

Own analysis shows that the loss of turnover in those sectors whose main product line is most suited to online purchases may be significant and these damped growth rates could potentially cut back the total rent roll for the centre. However, due to the high concentration of fashion and other retailers in the centre, the net loss would still not be too severe and is lower than for the town as a whole.

8.9.4 Cyberton floorspace categories under threat

We also examined floorspace data on Cyberton to determine those sectors most under threat from e commerce. We found that some 16.5% of floorspace was in ‘threatened’ categories (i.e. banks/financial, books, building societies, electrical, home entertainment, telephones, and video and travel). Currently less than 10% vacancy rates are common but if the supply of
retail units increased further, because of the impact of ecommerce and other forces in the high street, then rents would need to make an adjustment. Oversupply could then become an issue on the future pattern of rental growth in the town.

**8.10 Summary – Scenarios**

Evidence from our Cyberton Focus Group suggested that the majority of retailers, in a town with a high degree of Internet access, believed that online sales would only be about 2 to 4% of total sales in the town by 2005.

Given this, and the current levels of Internet access penetration nationally, underpinned by continuing fears over security and customer fulfilment, the most likely of our three scenarios appear at the time of writing to be the sluggish or growing scenarios, rather than a rapid scenario. This is true nationally and within Cyberton. This conclusion is even more compelling when ICSC research puts the online figure for the USA in 2005 at 4.7% of sales.

This also suggests that in the UK rental growth rate may be reduced by something less than 1% pa over the period 2000-2005, depending on the level of diversion from home as opposed to store based sales. This view also receives support from several of our interviewees. Moreover a recent report by Insignia (2000) suggested that if online sales reached 5-7.5% by 2005, then average rental growth could be reduced by 1-2% pa.

Such conclusions must carry a number of provisos, however.

- Any overall figure for rental growth is an average only. As the main results section showed, there will be winners and losers within and between towns. The scenarios do not include any views on financial services and travel, for example, which our survey suggests will be particularly hard hit. Similarly, well-managed, well-located prime retail property that blends the shopping, leisure and entertainment experiences, and integrates new online innovations, will prosper.

- Forecasting at a national level is difficult enough. Forecasting at a local level is even more difficult, especially because of lumpiness in supply coming onstream. Our national and Cyberton scenarios exclude the supply factor and adopt a rough and ready demand driven measure of sales and rents.

Our scenarios are also important for highlighting one important issue, however, and that is the importance of strong economic growth in driving both offline and online spending. If economic growth slows over the next five years, and the USA’s economic problems start to create a downturn in the UK and Europe, then not only will store-based retail be hit, but consumers will also be spending less online. We may, at the time of writing, already be seeing a slowdown in online spend in the USA, which appears to have stabilised at about 0.7% or so of sales over recent months.

Finally, our rental growth figures nationally and for Cyberton are ‘average’ views of the market. It was clear from our case study of the shopping centre in Cyberton how important the balance of floorspace in a centre can be in determining future rental growth patterns. We saw how even small sectors could impact on rental growth in a turnover-based centre if sales growth was adversely affected. By the same token the centre had a predominantly ‘Internet proofed’ retail mix, which should stand it in good stead for the future. Further analysis is also needed to see what impact changing overall patterns of floorspace would have on rents within particular sectors in the town.
9 CONCLUSIONS AND SUMMARY

9.1 Overview of the research
Our task in this research has been to provide a clear and concise overview of the key problems and issues, by taking a considered and holistic view from the retailer, investor/developer and shopper perspectives. Each, in their own way, is a key player on the retail stage, and our intention has been to provide a balanced and rational perspective on how the future direction of ecommerce and the Internet may impact on UK retail property.

More specifically, the research has aimed to provide a comprehensive study of the impact of ecommerce on the future space and ownership/leasing requirements of UK retailers over the period 2000-05. Through the use of scenario analysis we have presented three main views of the future and how rents may move nationally in the UK and, at a more local level, within our case study town (Cyberton), which included a major regional shopping centre currently on a turnover rent basis.

Based on our literature review, US case studies, and our surveys, interviews and scenario work, the following conclusions are now drawn.

9.2 Data Sources and Methods
We are confident that our study encapsulates the views of the major players on the retail stage at the time of writing. However, several points on data and methods need to be highlighted.

9.2.1 Postal survey sample.
This contained a large number of medium-large and small retailers and the number of retailers in the Top 10 was only five. This is important, because the UK has higher than average retail concentration levels. In 1998/99, for example, the Top 10 retailers accounted for over half of the total turnover of the top 800 retailers in the UK. However, we also interviewed five retailers of whom three were in the Top 10. We have also highlighted our results for retailers by size to show how larger retailers’ responses may differ.

9.2.2 Scenario Analysis.
The scenarios are an important way of indicating how rents may move as a result of sales diversion over the period 2000-2005. However, a lot depends on how much of this diversion comes from stores and how much from home/catalogue shopping because lost store sales will impact on rents whereas lost catalogue sales will not. To take account of this we have used both a 100% diversion from stores and a 50% diversion from stores assumption.

We have also adopted a fairly crude method of associating sales and rents over the next 5 years by assuming there is 1:1 relationship between sales and rents in real terms. This is to take account of the deflationary ‘noughties’. Ultimately ‘forecasting’ is a very skilled process, and our scenarios are not intended to be forecasts but rather views of how the future might develop. They do, however, enable us to say how rents might move if key assumptions held true.

Finally we adopted a standard rate of cannibalisation (93.5% of online sales each year) for sales diverted from what would have sold offline. This was based on Verdict data and other sources and was supported by the views of the retail focus group.
9.3 Key Findings

9.3.1 How is ecommerce developing in UK retailing?

The development of ecommerce comes at a time when retailing is facing pressures on a number of fronts:

- Changing work and leisure patterns.
- Demographic changes.
- Decreasing number of shop units and increasing consolidation of sales.
- Evidence of falling real sales densities, deflation and lower margins.
- Increasing globalisation.

Unravelling the impact of these from the impact of ecommerce is difficult because they are, in many ways, interrelated. For example, there is clear evidence that the Internet is reinforcing price deflation through greater transparency. However, our starting point has been to provide an understanding of how ecommerce is developing in UK retailing alongside these other forces for change.

Our survey work has shown that a large majority of UK retailers now have websites, but only about half of these are transactional. The use of digital TV, Internet kiosks and mobile commerce is expanding, particularly among larger retailers.

Multichannel strategies also seem to dominate with nearly half of all UK retailers in the sample looking to integrate the Internet with the existing business.

Ecommerce is also seen by many retailers as an opportunity rather than just a threat. This was certainly a message that came across very clearly to us in the focus group and interviews.

9.3.2 What are the barriers and drivers to ecommerce?

Customer fulfilment and security were seen as the main barriers to ecommerce by retailers, investors/developers and their advisers. In the interviews, logistics and delivery problems were also highlighted. The social and ‘agora’ features of conventional shopping were seen as important as well as technological factors, although bandwidth limitations were not an issue.

At a local level, demographic and employment shifts were important drivers, and companies with a strong brand would be the ones who would succeed on the Internet. We also found that even in a town such as Cyberton, with high Internet access, a ‘digital divide’ existed. Despite the inherent logic of Pareto’s optimum, which means that 20% of buyers produce 80% of sales, widening fast access to all income groups is essential if the Internet is really to take off.

Despite this, our survey of Cyberton also showed high levels of access (57% of respondents had access at home, and 72% had access at home and/or work). Use of the web for shopping is driving use in such locations. For example, we found that 39% of shoppers had purchased goods online and 45% had researched goods and compared prices on the Internet. Convenience and price were key reasons for choosing to shop online rather than in the town centre.
9.3.3 How important is ecommerce for retailers alongside other issues such as changes in accounting standards and shorter, more flexible leases?

Although our interviewees suggested that ecommerce was a major concern to them, other issues, particularly at a local level, were also seen as important by the retail focus group. This might include such issues as local accessibility and parking in the town centre and the increasing skills shortage in retailing which was also driving technological innovations.

Larger retailers were also concerned about the impact that the new accounting changes would have, and which might lead to a trend towards shorter leases. A major factor in this is the conclusion of the Accounting Standards Board’s discussion paper, “Leases: implementation of a new approach” (ASB, 2000). Currently, accounting rules favour companies that lease property over those which own it. Under the new regime, a lease will have to be shown as both an asset and a corresponding liability on the tenant’s balance sheet – in accounting terms much the same as if the company had borrowed money and bought the asset. Therefore the longer the lease, the bigger the liability.

9.3.4 How are UK retailers’ property requirements changing as ecommerce evolves?

Just as our discussion on ecommerce and its impact on retailing must be considered against the backdrop of other issues, the same is true of ecommerce and its impact on retail property.

Retail property faces a number of burning issues:

- The future for corporate retail property in the light of changing accounting standards and the moves to off balance sheet vehicles.
- Changing floorspace patterns as competition between in-town and out-of-town centres continues and planning policies bite.
- A slowdown in retail property investment performance.
- Falling lease lengths, reducing sales growth and higher rents.

Our sample of retailers in the postal survey was dominated by those based in the high street. Retailers generally held more leasehold space than freehold space. The average portfolio, for example, comprised 61% leasehold and 34% freehold space. In value terms, however, our analysis suggests the position is reversed. For example, in 1999 the mean percentage of freehold property (by value owned) in our sample of top retailers was 65.4% (see section 4). The same analysis also shows a drift to leasehold by value over time, however, as the figure for freehold by value was 68.7% in 1994.

The high levels of property ownership (by value) amongst retailers reflects the need for sale, storage and distribution, but also the high value of retail property. Indeed, property assets are often used by retailers as collateral for corporate debt in order to finance trading growth. However, as the proposed accounting changes bite, we may see a more substantial drift towards shorter leases.

Our survey certainly suggests that retailers would prefer to have shorter leases than they do already. Generally, leases are currently more than 10 years in length (particularly so in the large retailers group (77%)), with nearly 40% of retailers having average leases of 11-15 years. These figures are in line with earlier work by the University of Reading (DETR, 2000). More than 70% of larger retailers wanted shorter leases of 10 years or less, which we believe is due to the general increased demand for flexibility, underpinned by the forces outlined above.
We also found a drive towards possible refinancing and restructuring of property by larger companies (more than a third of the larger retailers were considering this, particularly through sale and leaseback), driven by:

- Need for flexibility
- Property market dynamics
- Availability of resources
- Ability to win business.

A view that came quite strongly from this was that the Internet was not reducing the demand for space.

The increased demand for flexibility has also resulted in the take up of turnover leases. Turnover leases are still not widespread in the UK, however. For example, for 70% of retailers who had turnover leases, they still only make up 10% or less of their portfolios. Similarly two thirds of investors using turnover leases only have 10% or less of their retail portfolio let on them. This supports the findings of research from IPD and the University of Reading which showed that in 1998 3.67% of shopping centre units in the UK are let on turnover leases. Despite this, a number of interviewees felt that turnover leases could become more common in the future.

Horror stories of deflation, falling margins and store closures do not seem to have adversely affected the bullish views of retailers. Our survey showed that 65% of retailers saw a need to increase their retail space over the next 3 years, and larger retailers were also looking to expand their distribution space. There seemed to be a tendency for predominantly leasehold space occupiers to be bullish about expansion in retail, perhaps reflecting greater optimism of their flexibility and response to changing demand than other more property heavy retailers. This is in contrast to recent surveys of retailer demand (e.g. CBI/GVA Grimley, FOCUS and RICS) which show a bearish view, with retailers holding or scaling back their expansion plans over the short term. The difference may be due to a combination of the varying timeframes adopted and sample compositions.

Those retailers who were reducing their space requirements were doing so for a variety of reasons. The importance of B2B, for example, was mentioned by one but the message is that ecommerce is not yet reducing the perceived need for retail space. This mirrors the findings from our restructuring/refinancing question referred to above.

Generally retailers expected their occupation costs to increase over the short and medium terms, and those who thought costs would stay the same in the short term felt they would increase over the medium term. Those who saw their costs decreasing were generally those who felt their space requirements would also decrease.

9.3.5 How and when will ecommerce impact on retail in the UK?

Our postal survey suggested retailers were more sanguine than developers/investors and their advisers about the impact that ecommerce would have on rental and capital values, yields and returns over the next 5 years.

Overall, respondents thought rental values, yields, capital values and returns were mainly at low to medium risk. Retailers were more likely than the property industry to consider these
factors to be at no risk, and a greater number of retailers also considered all factors except rentals to be at high risk. This suggests a greater polarisation of views in the retailer group.

Returns, capital and rental values are expected to fall and yields rise, although a greater proportion of property industry respondents believed this, perhaps reflecting their greater knowledge of property factors.

A majority of respondents in our survey felt that ecommerce would impact on UK retail property within 5 years. Retailers, investors and developers see the impact as taking a little longer than do investment advisers.

Banks and travel agents were seen as being most at risk whereas prime standard shops, large city centre shopping centres and out-of-town regional centres were less at risk. This suggests an overall risk spectrum, as shown in Figure 9.1.

We also found that comparison shopping is perceived as especially at risk in secondary locations. Investors and developers see niche retailing as the least risky of all sectors, with convenience retailing being viewed by all respondents as being less at risk than comparison shopping. Figure 9.1 summarises the key trends, which supports the views expressed in our literature review.

9.3.6 Does the pattern of Cyberton shopping support our findings from the retailer/ investor developer survey?

Our survey of shoppers also revealed that online purchases were often in the smaller sector, specialist categories such as travel, music and books. For instance 37% bought women’s clothing in the town and 5% bought online, and 2% of respondents bought travel services in the town centre but 20% bought travel online.

This pattern is mirrored at a national level where we found that there is an inverse relationship between UK online sales for particular goods and the same good’s share of overall retail sales. In other words, there is potentially a big ecommerce impact in small retail sectors and a small impact in large sectors. This is shown clearly in Figure 9.2 for two contrasting categories of good.

The corollary of this argument is shown in the right hand side of Figure 9.2. This shows the relative share of total online sales for each good in 2000. For example, although the online share of grocery sales is low (about 0.3%), the grocery share of online sales for all goods is 32%, which reflects the large size of the grocery market.

The Cyberton shopper survey also provided support for the view that cannibalisation of sales could impact in-town centres. Although we did not ask shoppers about the amounts
spent online, some two-thirds of shoppers said their online purchases had replaced some of the town centre purchases. Popular online products are also the most likely to replace town centre purchases. Some 33% of shoppers who made online music and video purchases would otherwise have made them in Cyberton’s music stores. Similarly 20% of shoppers who made online holiday and travel transactions replaced a visit to one of the town’s travel agencies. The proportions of replacement sales are much lower for other products.

Our scenario analysis showed how, in a town with higher annual household expenditure generally and different demographics (Cyberton), average online spend could be higher than the national average, even though the reduction in offline sales and baseline online share were virtually identical.

For example, nationally, annual household spending online is expected to increase from about £50 in 2000 to £238 (sluggish), £489 (growing), or £783 (rapid) in 2005. In comparison, Cyberton is expected to have higher annual online household spend figures: £284, £583 and £898 per household in each respective scenario rising from a figure of £60 in 2000.

Clothing and footwear is expected to have the highest online growth rates nationally (and in Cyberton) in the growing scenario, but its online share in 2005 nationally may still only be 4% in the ‘growing’ scenario. This reflects the likelihood of high diversions from home/catalogue shopping. Other categories of goods would have to grow at rates of between 26% pa and 70% pa to reach their respective forecast online shares in the ‘growing’ scenario by 2005.

9.3.7 What is the likely future path of ecommerce in UK retail?

As to the future there were fairly strongly held views that:

- To be successful, physical retailers had to find effective ways of combining shopping, leisure and entertainment.
- Polarisation between prime and secondary property was also likely to have an increasing impact.
- B2B and wired leases had some way to go before they impacted.
Digital TV and mobile commerce would be part of a multichannel future. These would be supplemented by kiosks and interactive services in shopping centres becoming more popular.

This also suggests the most successful shopping centres will be the ones that are well located with good access and have the characteristics shown in Table 9.1.

There will be an increase in the number of shopping centre websites in the UK and they will develop from purely informational to enable links to individual stores. This raises the issue of wired leases. The issues of returns and sales on the website away from the store, both of which can affect turnover, will need to be resolved. Evidence is already emerging of these changes with Peel Holding’s launch of a ‘virtual mall’ for the Trafford Centre in Manchester (Retail Week, 2001). The system will allow tenants to trade online under the Trafford Centre brand and is seen as a complimentary service for customers. Capital Shopping Centres have also announced that from June 2001 they will launch ‘virtual malls’ which will allow consumers to shop online at any of CSC’s 10 UK shopping centres (Estates Gazette, 2001). The scheme is a joint venture between CSC, Mall-UK and Affinity Internet Holdings and will be available on websites, interactive TV and WAP-enabled mobile phones.

On the issue of flexible leasing structures there is a trade-off here. If leases do become shorter, and if ecommerce continues to bite, we may see more aggressive management from owners in the UK to weed out under-performing retailers, just as is happening in some instances in the USA.

Bricks and clicks would seem to have the edge on pure-play etailers. The stock values of dot.coms have fallen dramatically during 2000, and the future of many is still uncertain. Perhaps the advantages of etailers being lightweight in property have been overplayed. Our limited survey of dot.coms (we had only six pure-play etailers) suggested that property was still needed even by etailers. There was also some limited evidence of ‘reverse convergence’, as etailers seek to expand their physical space.

9.3.8 What will be the likely impact on retail sales and rents in the UK?

At present the ‘sluggish’ and ‘growing’ scenarios seem to be more compelling than a future based on ‘rapid’ growth. This suggests by 2005 that the online share may be of the order of 2.5% to 5% of total retail sales (including home shopping, but excluding financial services and travel). Although it is impossible to be categorical this view is lent some support by the fact that:

- Both scenarios require compound growth rates well in excess of even the heady days of US catalogue shopping to reach their required share (37% pa and 58% pa). The ‘rapid’ scenario requires 73% pa growth and assumes Internet access and broadband access can be rolled out very quickly over the next 5 years.

<table>
<thead>
<tr>
<th>Table 9.1 What will make UK shopping centres successful over the next 5 years?</th>
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<tbody>
<tr>
<td>Active management</td>
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<tr>
<td>Good links with town centre management</td>
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<tr>
<td>Excellent layout and tenant mix</td>
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<tr>
<td>Shoppertainment</td>
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<tr>
<td>Multichannel with Internet access (shopping centre website with store links)</td>
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<tr>
<td>Tenant information systems (possible web-enabled B2B supply chains?)</td>
</tr>
<tr>
<td>Excellent delivery/collection systems</td>
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<tr>
<td>Flexible leasing options for tenants</td>
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BCSC
In Cyberton, a town with a high degree of Internet access, retailers’ views converged around the 2-4% share by 2005.

In USA (thought by some to be ahead of UK in ecommerce), although the current online sales share is 0.8%, research commissioned by ICSC from the University of Madison, Wisconsin, forecasts the figure for online sales to be 4.7% of total retail sales by 2005, much less than other ‘bullish’ forecasts. Many also believe the future introduction of an Internet sales tax may stifle further online growth.

Our scenarios also show the impact of 50% diversion from stores and 100% diversion from stores. It seems more likely that at least some diversion of sales will come from home catalogue shopping, making a 50% diversion more likely. If this is the case, then our scenarios suggest rate may be reduced by 0.2% pa to 0.45% pa over the period 2000-2005 in each of the two scenarios (sluggish and growing respectively).

However, this is an average figure only and our Cyberton and shopping centre case study showed the need to examine floorspace balance carefully within towns. In our shopping centre study, the potential reduction in rental growth was negligible (about 0.1% pa) in the ‘growing’ scenario, (on the assumption of a 50% sales diversion from stores). Shopping centre owners will therefore face a major challenge in determining the right balance between a tenant mix that optimises shopping centre footfall (e.g. a large chemist store), captures spending growth (e.g. household goods) and minimises exposure to sectors most prone to online diversion (e.g. books).

It is also clear from our analysis that there is a very real and continued threat to financial services and travel. In Cyberton some 16.5% of space is in threatened categories, which includes those services.

Therefore, retailers cannot afford to be complacent. Our desktop analysis of retailers’ accounts showed that with low margins a number are under threat even if turnover levels fell by less than 5% pa. This may well prove to be the case in some sectors even in the ‘sluggish’ and ‘growing’ scenarios.

9.3.9 What lessons, if any, can be learned from the USA?

In the USA the ecommerce landscape differs, and it is also true to say that the US shopping experience and retail industry is very different from our own. This has also been reflected in the relatively rapid growth of web access to shopping centres in the USA (88% of shopping centres currently have websites compared with 10.5% in the UK), a country where the geographical scale of things is much greater. Nonetheless, valuable lessons can be learned from the US experience of companies such as Simon Property.

The Simon Property and Discovery Store case studies in the USA highlighted some emerging themes from the US experience:

- The first-mover trend by the large US property companies towards large-scale web-enablement of retail-based supply chains in their shopping centres. This is on a different scale from anything so far attempted in the UK.
- The increasing importance of ‘shoppertainment’ as a key theme in US retailing, which combines the best elements of shopping and leisure in store and centre design.
A trend towards restructuring of existing landlord and tenant relationships in the US, perhaps made easier by the sheer consolidated scale of the major US property developers/investors, the dominance of the turnover leases, absence of security of tenure, and upwards only rent review clauses, and the presence of shorter leases.

Although the UK can learn from the US experience, and although ‘shoppertainment’ is already a theme that is well recognised over here, the sheer scale of restructuring supply chains and leases in shopping centres is probably unlikely to appeal to more conservative investors/developers in the UK in the short term. Nonetheless, if the wired and bricks and mortar worlds are to be combined effectively, ‘wired leases’ may well become an important part of the UK scene over the longer term.

In the UK, there has been much debate about how wired leases, which can capture Internet sales, might work. The suggestion is that such leases should be based on a percentage rent, based on retailers’ sales generated through the shopping centre store, and a percentage of sales made through the centre’s Internet sites, so capturing ‘rent’ from multichannel retailing. Wired leases have been promoted by JLL in the UK, with Land Securities and Richardson Brothers alleged as considering such leases in Birmingham and Manchester (Printworks Development). The results of our survey suggest there is still a long way to go before such leases become anything more than a talking point.

Nonetheless, already in the UK investors and developers are looking at new ways to develop stronger synergy between themselves and retailers. As one of our UK investor/developer interviewees put it:

‘Ecommerce is clearly an opportunity for retailers. But perhaps not in the way that the US trend has taken off. We think the opportunity is in enhancing our intelligence and therefore our ability to continually evolve them, both from a consumer and tenant point of view of view. So if you web-enable information flows from which you can capture stuff, and if you capture it you can mine it, and then you can continually evolve the physical offer, the content within the centre, the brand, its presence and what its meaning is with the people that want to interact with the brand… The value of brand marketing is the brand value that you can build way beyond the traditional catchment definition.’

9.3.10 Significance of the research – can we debunk any myths?
The research supports some of the findings from previous work. For example, security and fulfilment were major barriers in the National Consumer Council (2000) research. It also supports some of the qualitative scenario studies from Jones Lang Lasalle (2000a) and others (e.g. Sparks & Findlay, 2000). Building on the work of CRIC (1999) and others, our scenario analysis enables us to be much more specific in terms of outcome than some of these studies, however. We are also confident that our survey work enables us to present an authoritative picture of the major players’ views of the impact of ecommerce on retail property to 2005.

In short, the findings of our research enable us to debunk some ‘myths’ fairly robustly.

‘Ecommerce will mean the death of the high street…’
False. Although parts of the high street are under threat (particularly financial services and travel), those stores that integrate ecommerce and have a strong brand will continue to be...
successful. What is difficult in any research of this kind is to tease out the impact that e-commerce will have, alongside all the other concerns there are over retailing, including price deflation, falling margins and rents outstripping sales. Certainly there will still be concerns for retailers operating on low margins, despite the impact B2B may have on costs. Technology changes rapidly, however, and so it will be vital to monitor and benchmark progress as we move towards a future where fast Internet access will widen in scope.

‘Retail property values will be hit...

Only partly true. There is mounting evidence to suggest that this is already happening, and not just because of e-commerce. Retail yields have generally moved out during 2000 because of more pessimistic investor sentiment over such factors as the weak retail market and oversupply of accommodation. But e-commerce is likely to increase the polarisation between prime and secondary property and between towns. If e-commerce slows rental growth by up to 0.5% pa over the next 5 years then we will also see yields moving further to accommodate this fall, if they have not done so already. As another risk factor, e-commerce will have a differential impact on particular kinds of property, as we have seen in the research. Clearly, if economic growth slows, then that would also hit spending, sales and ultimately rents, but then all forms of shopping would suffer, not only store-based shopping.

‘The future lies with dot.coms...

False. This seems unlikely to be true. The future seems to be very much multichannel with ‘bricks and clicks’ dominating. For example, Webmergers.com suggest that 210 US Internet companies folded in 2000, with 75% in the B2C sector. There have also been a litany of failures in the UK sector. With high cash burn rates and falling stock value, dot.coms are no longer the rising stars they once were with analysts. Finally, in February 2001, Amazon.com, the world’s largest online retailer, announced plans to cut 1300 staff or 15% of its workforce, but also forecast that its sales would be 10% lower than expected in the coming year.

‘Retail property will be deadweight...

False. Even etailers need property to operate. Retailers want more flexible leases and are looking in some instances to move property off their balance sheets because of accounting changes and other drivers. ‘Reverse convergence’ may become more common as etailers move into physical property and retailers move into virtual space.

9.4 What are the policy implications?

The research has also highlighted a number of potential policy implications:

Town centre management.

Close relationships between developers, retailers, the local authority and town centre managers are important to maintain. In Cyberton this works well and is a sound way of monitoring the impact of e-commerce on retailing and spending within the town. Synergy through the development of Internet kiosks to widen access in the town are an important outcome of such close working partnerships.

A3 uses.

If financial services continue to contract, the possible conversion to A3 uses may reach its limits. Physical banking is still needed and the implication of continued decline of demand for
space in such uses will require closer examination, particularly at a local level. For example, many streets in the West End are characterised by specialist and convenience shops, traditional pubs, small family-run restaurants, studio and media uses and residential property. However, this character is being eroded by the sheer concentration of bars and restaurants, and by the nature of many of new A3 uses. This and other areas have become saturated with A3 uses and have become less attractive to some groups – for example, older people and families. Shopping in some centres may also have been undermined by change of use from shops to restaurants and bars.

**Regeneration.**

If ecommerce changes the shape of cities and urban form through polarisation, this has important implications for urban regeneration as some areas of a town decline and others grow. The same is true at a regional level with Internet access rates varying and with different types of centres set to win and others lose as ecommerce begins to impact.

**9.5 What further research is needed?**

This research is a snapshot in time. Ecommerce is a continuously moving target and as we move through 2001 technology and economic conditions will change. It will therefore be important, we believe, for us to continue our survey on an annual basis to benchmark, evolve and develop our scenarios more closely.

It will also be important to monitor developments in both Europe and the USA as property investment has an increasing international and pan-European dimension.

Finally, at both a local level and national level it is very difficult to unravel ecommerce from the other factors which are impacting on retailing. Our future research in this area will examine how scenarios can be disaggregated to take account of floorspace differences for retail use and how this may impact within the overall ‘average’ figure that is provided.

Perhaps the last words lie with Sir Alec Cairncross (1971), the great economist, who wrote:

‘A trend is a trend is a trend. But the question is, will it bend? Will it alter its course through some unforeseen force and come to a premature end?’

That, as far as ecommerce is concerned, is the 64 million dollar question as we enter the next 5 years.
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GLOSSARY

The following is a short glossary which defines commonly used terms in the report.

B2B (Business-to-Business)  Ecommerce carried out between businesses.

B2C (Business-to-Consumer)  Ecommerce carried out between businesses and consumers, including retailers or etailers and shoppers.

Bricks and Clicks Retailer  A retailer who has combined existing stores with an ecommerce channel.

Bricks and Mortar Retailer  A retailer who continues to operate from stores only (also often called a ‘legacy’ play by some analysts).

Burn Rate  The rate at which a new company uses up its venture capital to finance overheads before generating positive cash flow from operations. It is the rate of negative cash flow, usually quoted as a monthly rate.

Cannibalisation Rate  The amount of online sales that are taken or diverted from store or home based (offline) sales.

Dot.com  A company which is Internet-based and operates the majority of its activities online. Ecommerce  The exchange of information across electronic networks at any stage in the supply chain, whether within an organisation, between businesses, between businesses and consumers, or between the public and private sectors, whether paid or unpaid.

Etailer  A retailer who operates entirely on the Internet (also referred to as pure-play). Incremental Rate  The amount of online sales that are entirely new sales, and not cannibalised.

Legacy Retailer  See Bricks and Mortar Retailer

M-commerce  Mobile commerce, or ecommerce carried out using mobile devices such as mobile phones or personal digital assistants (PDAs).

Multichannel Retailing  Retailing which integrates physical stores and Internet-based shopping through a number of channels. Internet access may be through a variety of devices: PCs, Digital television or WAP, for example.

Offline Sales  Sales which are carried out through stores or home/mail order/catalogue channels. Online Sales  Sales which are carried out over the Internet.
<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure-play</td>
<td>See Etailer</td>
</tr>
<tr>
<td>Reverse Convergence</td>
<td>The tendency for etailers to move into physical property and bricks and mortar retailers to move online.</td>
</tr>
<tr>
<td>WAP</td>
<td>Wireless application protocol, or the technology which enables portable devices (mobile phones) to use the Internet.</td>
</tr>
<tr>
<td>Wired Lease</td>
<td>A turnover (or percentage) lease which incorporates a physical store-based turnover element and an Internet-generated turnover element</td>
</tr>
</tbody>
</table>
APPENDIX A CYBERTON SURVEY

This Appendix presents some additional data that was collected during the shopping survey in Cyberton.

What people purchased
For most products purchasing levels remained the same on both survey days. However, high value comparison goods (in particular electicals and furniture) and men’s clothing showed a highest purchase rate on the weekend survey day. For example men’s clothing was purchased by one quarter or respondents on the Saturday, but on the Wednesday it only account for 14% of purchases.

There was also a clear divide in the products being purchased by men and women as shown Table A1.

<table>
<thead>
<tr>
<th>Table A1 Top five products categories for men and women</th>
</tr>
</thead>
<tbody>
<tr>
<td>MEN</td>
</tr>
<tr>
<td>1. Men’s Clothing</td>
</tr>
<tr>
<td>2. Food and Groceries</td>
</tr>
<tr>
<td>5. Electricals</td>
</tr>
</tbody>
</table>

Frequency of visits
Figure A1 shows the frequency of visits made to Cyberton for shopping purposes. The bulk of respondents visit at least once a month (87%), but there were many (56%) who claimed to shop in the town centre at least once a week.

Shoppers were also asked about how often they visited three key areas of the town centre: the two indoor shopping centres and the main retail thoroughfare. Not unsurprisingly the main thoroughfare is regularly visited by shoppers due to its easy accessibility and presence of major national multiples (see Table 2). The primary centre is also regularly visited, but is not
as popular amongst respondents as the main shopping street. The secondary centre is least popular with 41% of shoppers saying they never visit it or only do so occasionally.

There was some element of favouritism amongst shoppers for certain centres. For instance those interviewed along the main shopping street were likely to visit all the shopping locations as much as the others. Shoppers interviewed outside the primary centre were most likely to visit it, but not as likely to go to the secondary centre. The reverse was the case for shoppers outside the secondary centre (see Table 2).

Table A2 Frequency of visits to main retail locations on a typical visit to Cyberton (all shoppers)

<table>
<thead>
<tr>
<th>% OF ALL RESPONDENTS</th>
<th>PRIMARY CENTRE</th>
<th>SECONDARY CENTRE</th>
<th>THOROUGHFARE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Always</td>
<td>48%</td>
<td>31%</td>
<td>77%</td>
</tr>
<tr>
<td>Sometimes</td>
<td>28%</td>
<td>28%</td>
<td>17%</td>
</tr>
<tr>
<td>Occasionally</td>
<td>17%</td>
<td>21%</td>
<td>5%</td>
</tr>
<tr>
<td>Never</td>
<td>7%</td>
<td>20%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Figure A2 Frequency of visits to main retail locations on a typical visit to Cyberton, by interview location (all shoppers)
APPENDIX B  SCENARIOS

Key inputs
The key inputs in the models are:

- Online share of total sales in 2005;
- Growth of Internet access and the propensity to shop;
- Retail sales growth; and,
- Cannibalisation rates.

Online share in 2005 varies between scenarios: 2.5% of all retail sales for the ‘Sluggish’ scenario; 5% for the ‘Growing’ scenario and 7.5% for the ‘Rapid’ scenario.

The growth of Internet access and propensity to shop also differs in each scenario. Although we have not quantified access levels directly, we assume that there is a greater propensity to shop online (driven by wider access levels in society) in the rapid and growing scenarios than the sluggish scenario. Government policies and other socio-economic drivers are assumed to push these developments, but these are based on qualitative judgements.

Real retail sales growth (i.e. volume sales) is forecast to be 2.8% pa over the period 2000-2005, with inflation expected to run at less than 1% pa. This is based on ONS data and Verdict data plus other sources. By holding growth constant over the three scenarios we are better able to compare end results. Moreover the impact of varying the retail sales growth rate is examined in the results section.

Real retail sales growth includes all retail sales (non-food and food) and both store-based and home/catalogue shopping, but excludes online shopping. This is in line with Verdict’s definition of ‘retail sales’ and so also excludes financial services and travel services. However, we have also produced separate forecasts for both of the latter at a national level because they are an important feature of high street floorspace.

Cannibalisation rates have been assumed at a constant 93.5% both in 2000 and in 2005. This means that each year between 2000 and 2005, only 6.5% of online sales will be brand new sales, with the balance (93.5%) drawn from conventional sales channels (store and home shopping). The issue of cannibalisation is examined in more in more detail below. The evidence for cannibalisation clearly varies and later on we show how varying the rate can impact on potential lost sales growth.

How sensitive are the scenarios to changes in inputs?
To examine the sensitivity of the models to changes in retail sales growth and cannibalisation rates we reran the scenarios.

For example, if economic conditions reduced the retail sales growth rate to, say 1% pa for 2000-05 for each scenario, then we found that the reduction in annual sales growth would be lower, at 0.37% pa, 0.86% pa, and 1.37% pa for the ‘sluggish’, ‘growing’ and ‘rapid’ scenarios respectively. These are lower loss figures overall than the 2.8% retail sales growth assumption produced because online share in the three scenarios is highly dependent on all retail sales growing strongly.
Cannibalised and incremental sales

When online sales grow they may do so at the expense of existing offline sales (i.e. they are ‘cannibalised’ sales) or they may grow as entirely new sales, which would not have otherwise occurred (i.e. they are ‘incremental’ sales).

Opinions differ about the proportion of incremental and cannibalised sales in online growth and Figure B1 shows some of these.

For example, usually as a percentage of online sales by value:

- NPD Group indicated that 77% of online apparel sales in the USA were cannibalised from other formats (catalogues and stores).
- Jupiter Communications reported that 94% of all US Internet B2C sales were cannibalised in 1999. In other words only 6% of sales were incremental in 1999, and this is expected to increase to 6.5% in 2002.
- Verdict (2000) reports that in the UK only 6.5% of sales will be incremental in 2005.
- Stores and Ernst & Young (2000) suggest that in 1999 in the USA, 43% of the purchases made online were incremental; in the UK, the equivalent figure was 40%.

The Ernst & Young survey is the most bullish of these and suggests ‘total spending on goods and services is growing as a result of Internet access’. However, this implies incremental purchases are being made without any budget constraints. It is in fact very difficult to know by how much consumers reduce alternative retail spending to be able to make room in the budget for the Internet purchase.

The issue of incremental versus cannibalised sales is important because the higher the degree of cannibalisation of offline sales to online sales, the greater the impact on potential lost growth in the offline sector.

Actually, the loss in relative growth arising from these figures on a flat 1% pa increase in retail sales would have more serious consequences for retail than if volume sales were growing more
A reduction in cannibalisation rate, however, would clearly have a less detrimental impact on offline sales, other factors remaining unchanged.

The effect of changing the rate is shown in Figure B2. This shows that if 99% of sales were cannibalised (compared with 93.5%) under the ‘growing’ scenario, the reduction in online sales growth would still be about 0.9% pa. However, if cannibalisation was much lower (say 10%), other factors remaining unchanged, the loss in sales growth would also be lower (at about 0.1% pa) as one would expect.

Cyberton forecasts

We used the same three scenarios at the town level:

- The online share of sales was assumed to be the same in 2000 and 2005 as at a national level to make comparison easier.
- The same rate of cannibalised sales (93.5%) was also used and the growth of Internet access and propensity to shop online assumed the same as the national scenarios.
- We did not investigate travel and financial services in detail in Cyberton.
- We also assumed the same relationship of retail sales to rents as the national picture (i.e. a relationship of 1% retail sales to 1% retail rents).
- However, retail sales growth (volume sales excluding online sales) was forecast at 3.35% over the period 2000 to 2005, reflecting the generally buoyant location and economic conditions in the town.
- Inflation was again assumed to be less than 1%. For individual product growth under the growing scenario we used adjusted national growth rates to bring them into line with the stronger economic growth in Cyberton.

Key problems arise in forecasting at a local town level. These include:

- Defining boundaries and overlapping demand areas;

strongly at 2.8% pa. For example, in the growing scenario under the 1% pa assumption of retail sales growth, the 1% pa growth would have been 1.86% pa were it not for online sales diversions. This compares with a potential sales growth figure of 3.68% pa, under a 2.8% pa retail sales growth assumption (i.e. a loss of 0.88% pa to online sales).

We also examined cannibalisation rate. As the cannibalisation rate in our scenarios is already high at 93.5%, increasing the rate still further has little impact.
- Competing supply, which tends to come on-stream ‘lumpily’ either in the same urban area or a competing one;
- Availability and quality of data; and,
- Importance of other factors, such as road building, planning policy, pedestrianisation, car parking, and changing tenant mix which are not easily incorporated into any model.

At a local level, supply changes can have a substantial impact. We have assumed for the purposes of all forecasts that retail floorspace supply remains stable over the period 2000-2005.

**Rents and Retail Sales**

Previous research has established a strong relationship between retail rents and retail sales. Inflation-adjusted rents and sales volumes are commonly used in such national forecasts. Work by Hoesli and Macgregor (2000) and by Key et al (1994) has established that, over the longer term, the relationship between UK retail sales and real retail rents is of the order of 1: 1.5 depending on the time period adopted and lag effects. Work by PMA in relation to non-food retail sales and town centre retail rents has also established a relationship of the order of 1:1.5 to 2.

In our scenarios we have adopted a 1:1 relationship which is intended to reflect the expected ‘deflationary’ noughties.