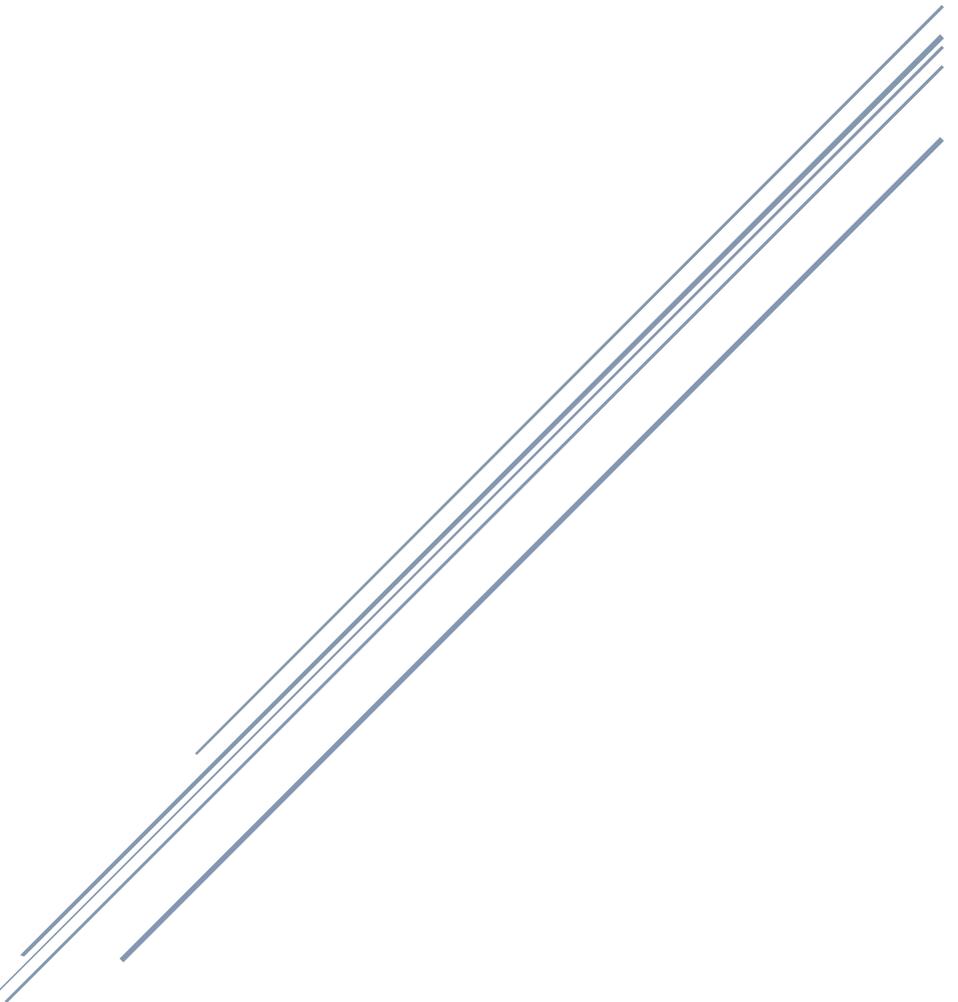


MALL MECHANICS

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## Mall Mechanics

**Shopping Malls may emerge as the next form of retail evolution in India. But not unless a more integrated approach to mall development is followed.**

*Synopsis: Developers, shoppers and retailers all struggle to find quality retail space and an enthralling visit experience. What is lacking is development of a nuts and bolts approach to retail development, and an appreciation of the requirements of the mall format. This short paper outlines some of the key problems and possible approach to mall development for both retailers and mall developers.*

*Keywords: India, retail development, mall development, retailing.*

It is useful to first ask why malls have not taken off so far. Surprisingly, both developers and consumers are almost totally unaware of the possibilities. Everybody thinks of shopping centers as dingy enclosed 'bazaars', instead of enjoyable social centers.

Consumers in India have existed in a seller's market, and have been conditioned to accept a poor quality retaining experience. Even in a small degree of upgradation is equated with high prices. However, altitudes are changing rapidly, driven by exposure to satellite media and raising incomes. What draws crowd to select properties such as Spencer Plaza and Alsa Mall in Madras, Ebony and its counterparts in Delhi and Shoppers Stop in Mumbai? They are there for the experience. Yet, they are still unaware of how much better the experience could be.

Besides, developers are also reluctant to enter the business because of difficulty in assembling large parcels of land in locations with good connectivity to other parts of the city. City center locations are prohibitively expensive, while edge of town locations do not generate sufficient customer traffic. (This actually means that the old times corporate who own large properties inside the city can become major players). There are very few developers and corporate in India with experience and the long term perspective to invest time and resources into developing and following a mall management strategy.

### **So will India see malls of the kind witnessed in other Asian countries?**

Yes, but a new format usually emerges after major demographic shifts. For example, as retailers followed customers into the suburbs. In Asian economies such as the Philippines and Hong Kong, they developed as a result of urban pressures, and increased consumer sophistication.

We expect to see similar developments here due to the saturation in metro development. The first signs are already evident in Mumbai. For example, in Mumbai, population and economic activity has long been shifting out of the island city – first to the western and now the eastern suburbs. Markets in these areas are developed and matured. A case in a point would be Linking Road the up market high street in Bandra, Mumbai. It is initially catered to the needs of Bandra residents, and then as more retailers followed up market customers out to the suburbs it evolved organically into a high street brand by itself. During this process, shopping at the location has changed form purposive goal- oriented activity to a lifestyle activity. There is a little scope for further development, and the only changes now possible relate more to up gradation rather than new development. Other areas such as South extension in Delhi and Brigade road in Bangalore show the same pattern.

The next evolutionary step is to develop integrated shopping complexes/malls in destination locations that meet people's need for a total leisure experience in the guise of a shopping expedition. These would offer leisure and retail facilities in an integrated manner that gives maximum benefit to retailers, maximizes the fun of shoppers and optimizes the returns for the developer. Thus they are likely to be the next step in retail evolution in India due to benefits to all stake holders.

There is no question that mall development fits in well with the Indian retail scenario. Malls are an outcome of the need for better quality retail space, the need for retail property owners to make best use of their assets. The general evolution of Indian retail scenario also calls for evolution of a more economical format than costly stand-alone stores that are now the norm.

### **But will malls have to be structured differently here?**

Yes. Every mall has to be tailored for specific cultures and localities. For example, malls throughout Asia tend to be smaller than their American counterparts, with commercial space for offices, reflecting the fact that they are usually located within high density urban areas, rather than the edge locations in the US. So, they tend to be more 'vertical'.

This means that the merchandising approach, the merchandise mix and decisions on tenant locations inside the mall are far more complex. Asian shopping centers cannot merely reflect a foreign business system, but have to be very specific in their appeal by developing a tenant body that reflects the need of the targeted customers, local real estate demand, and the quality of competition.

### **How, therefore, should the development of this shopping format be approached?**

The developer and the mall operator tend to have conflicting objectives. The developer likes to sell off the property as fast as possible so that he can recover his returns, while the mall operator has to maximize the rental income over a period of time. Thus a proper retail space development strategy has to be thought out and implemented.

This can be done by splitting the development role from the operational role. From the Coopers and Lybrand experience abroad, we have seen that the most popular route that the developer sets up a special purpose vehicle (SPV) i.e., a separate company which actually owns the property (or its lease). His equity contribution to the SPV can be in the form of property. Other investors provide more equity funds, while financial institutions provide loans. The SPV develops the property and set up a mall management company as a subsidiary to actually run the mall and provide dividend income to the SPV, the developer has the choice of selling all or a part of his equity in the SPV at an appreciated price, or to continue to get the benefits of the income generated by the management company. He is thus able to maximize his realizations from the property at a far lower level of exposure than if he had decided to develop and operate the entire project on his own,

On the other hand, the mall management company is able to attract good anchor tenants, and develop a mix of tenants that guarantees visitor volumes. It is able to control tenants and charge premium leases. Tenants get high quality service from the mall managers, and customers enjoy better facilities and services. Voila, everybody wins!

### **How is it a win-win arrangement for retailers and consumers?**

Stand-alone, family-owned outlets usually do not have the resources to keep up with fast changing trends. It is physically not possible to grow/expand in high street locations. A mall would allow city retailers to come together to achieve critical mass in retail space, and quality of offering, since they get the benefit of a composite brand pull that generates higher traffic volumes than a stand-alone store.

As the customers become more discriminating, retailers have to develop segmented appeals. Malls must appeal to large-scale manufacturer/retailers who require focused retail targeting such as Bata who have differentiated their stores into 3 types for different market segments. Malls can also be positioned to appeal to different markets by changing the tenant mix and location. For this reason, in mature markets, malls are developed in close coordination with the large stores that shall act as anchor tenants. Thus they can provide a much focused channel, with great synergies in customer appeal.

Mall space is also an attractive site for corporate entering into retailing, quality space. Also, if it is put up by a reputed developer, the level of transparency on property transactions is likely to be much higher, and therefore more appealing to multinationals and Indian corporate. For whom traditionally murky real estate market practices have acted as a major entry barrier.

### **What about customers?**

Convenience and choice remain the major criteria for the most customers, across all socio-economic groups. When you marry the convenience of a wide variety of stores available at one location, with the resulting choice in brands, product categories and price levels, the malls become a major attraction to customers. When you consider that in an integrated mall you can offer entertainment facilities such as restaurants, cinemas, skating rinks, video game parlors etc. The attraction is unbeatable.

### **But what is the best developmental route for the mall management team so that the developers stand to gain?**

The success of a mall for the developer is measured by the returns achieved through property sales, rentals and other income streams. Sales should form only a small portion of total returns, as it is unlikely that the developer can harvest the entire value of the property immediately. Since rental accrues over a longer period of time than from direct sales of space. Appropriate leasing by the management company allows the developer to maximize the realization from the property through direct income, as well as from sales to running retail property, for which he can charge a premium.

Being able to quickly increase the asking lease amount depends on not only maintaining property well, but by developing a tenant group that other tenants want to associate with and that attracts customers. There also has to be a mall marketing effort to develop the right image. This is the area where most shopping complex developers in India fail.

Leases are set based on market conditions and the value put on the image of the mall. For a successful property, lease income can jump manifold to reflect the increased value of the property. Though leases are not popular in India due to occupational problems with tenants, mall owners could avoid difficulties by negotiating leases directly with companies, using well-structured documentation and allowing the company to sublease or rent out the space to representatives (franchisees or others). This would be a major plus point with multinationals and corporates who would value this sort of transparency.

Other income sources the mall developer benefits from are parking lots (important for the amount of cash income they generate daily) and display rentals (signage, hoardings, exhibitions, etc). The importance of these income streams for mall viability can be seen from the fact that at least one development deal in a major Indian city has fallen through because the state government wanted to retain the critical parking and display rights.

### **What ensures long-term success?**

That's tied to the management expertise in capturing the tenant's mix that best develops a mutually supporting appeal. Most developers in India do not have a tenant strategy; the result is seen in a sub-optimally performing 'indoor bazaars' with a quaint mix of retailers. These do not provide value to the retailer, the customer and least of all to the developer.

To achieve the best results, the mall management company must be set up to maintain the property, develop the best tenant mix, market retail space and promote the mall as a brand. This is a critical part of value enhancement.

### **Tenant strategy? What's that?**

A tenant strategy means building that portfolio of occupants that appeal to consumers, especially the increasingly large number of recreation oriented visitors who visit malls for family or social reasons, combining shopping with entertainment. This phenomenon is highly prevalent in our Asian cultures which give more importance to communal life, and have small living quarters. The tenant mix must reflect their needs and the portfolio must be re-evaluated at every lease expiry. If a tenant does not do as well as expected, or conversely expands too much, the company can be evicted or shifted at the end of the period.

An important aspect of tenant strategy that Indian developers must remember is that appealing to entertainment hunger through dedicated facilities such as arcades, cineplex's etc is risky without considerable study of the market. Because of high real estate prices, dedicating space to amusements is a larger financial risk than a totally retail-oriented area, though payoffs can be much greater.

### **What is the Economic model followed?**

Usually rent charged is structured into two parts – a percentage of the mall's average sales per square foot as a fixed minimum rent , plus occupancy charges that cover taxes, insurance, air conditioning expenses, utilities , cleaning and security services, the maintenance costs for common areas. This structure requires the retailers to link their tills to a common computer system. This is common in many of the malls in Asia but not be acceptable here.

Setting the lease rate appropriately is critical. If the lease level works out to more than the average for the mall , the mall is said to be 'over rented' and the property shall experience tenant abandonment and a climbing vacancy rate. If rents are lower, the developer gets sub-optimal returns and rents would have to be substantially increased on expiry of the lease period.

The lease amount is usually structured so as to reflect the space taken up and the crowd pulling capability of the tenant. Tenants taking up large spaces and able to attract large volume of visitors are approached first and in their role as anchor tenants are provided with substantial discounts on the base asking rate s to entice them into taking up space . Rentals based on a percentage of store turn-over are

common abroad, and are in fact preferred by many retailers as the mall management then has a stake in increasing the turn-over of tenants. It goes without saying that this arrangement depends on a high level of trust between retailer and developer, in addition the mall management company charges a royalty or service fee to cover the costs of managing the mall i.e., managerial personnel associated office expenses, as well as marketing costs such as newspaper , advertisements , promotions etc.

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## About the Author

Atul Vaid has extensive experience in strategic planning, market entry consulting and new initiatives development. He has 20+ years of consulting and corporate experience with global firms, where he has handled a variety of assignments in India, the Middle East, the USA and Japan; as well as cross-border engagements run remotely out of India. He has set up the marketing services hub for a US-based management consulting and technology firm, started an online skills assessment portal, and run a global innovation program for a strategy consulting firm.

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