

# RETAIL TRAFFIC

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## MANAGEMENT OFFICE

# All The Right Moves

Chain Retailers often feel pressured to open new stores, but they should pay close attention to their site selection strategies.

By Elaine Misonzhnik

Apparel giant Gap Inc.'s decision this summer to close some stores and downsize others was no surprise to retail analysts. After all, San Francisco-based Gap has reported losses for 15 straight quarters and is frequently mentioned as a possible bankruptcy candidate. Most industry observers attribute the chain's decline to poor merchandising decisions and the departure of retail legend and former president and COO Mickey Drexler in May 2002.

But it turns out Gap's decline was not solely due to poorly thought-out inventory choices. During the company's second quarter conference call on Aug. 21, chairman and CEO Glenn Murphy dropped the bombshell that for all these years, the retailer was not employing a coherent plan for its 3,100-store fleet.

"We've never had a clear real estate strategy," Murphy, who was appointed to his post in July 2007, told analysts. "That was one of the first observations that was made when new management came in."

Considering how many resources retail chains have at their disposal today to help them make smart real estate decisions, Murphy's admission seems to defy all logic. After all, Gap employs an extensive real estate department. Furthermore, there is no shortage of leasing experts, consultants and site selection specialists in the marketplace who are ready to offer their services to expanding chains. The problem is that most retailers, especially publicly traded firms, are under enormous pressure to expand and gain market share. That "grow at all costs" mentality leads to sloppy homework. It also means that Gap's

story is not unique, says James C. Bieri, president and CEO of the Bieri Co., a Detroit, Mich.-based retail real estate consulting firm.

Bieri points to another ubiquitous chain—Starbucks Inc.—as an example of an expansion campaign gone haywire. In its heyday, Starbucks gained fame for its targeted real estate strategy. When considering opening new stores, it would look not only at income levels and traffic counts in a given location, but at the education levels of its potential customers and the availability of easy exits off the highway, among other factors. But in its efforts to become the No. 1 coffee seller in the country, the chain became too lax about cannibalization possibilities, opening new stores around the corner from old ones and going into markets where the demographics did not fit its core customer base. As a result, the chain is now being forced to close 600 underperforming stores stateside.

Seattle-based Starbucks declined to comment for this article, but the chain's spokesperson said the retailer takes into account demographic information, Starbucks' human and financial resources and level of coffee knowledge in an area when opening new stores.

At the same time, some retailers consistently get it right. Specialists point to the Container Store, Costco and Sephora, among others, as firms that employ intelligent growth strategies and have resisted expanding recklessly. What do these chains have in common? To begin with, those firms employ a clearly defined, uniformly enforced real estate strategy, says Eileen F. Mitchell, executive vice president with RCS Real Estate Advisors, a New York City-based retail real estate consulting firm. These companies understand who their core customers are, where they live and where they do their shopping, notes Mitchell.

They also try to avoid another pitfall of rapid expansion. Retailers need to be careful about figuring out the economics of their expansion plans, says Ted Parris, senior vice president for retail with Grubb & Ellis, a Santa Ana, Calif.-based commercial real estate services firm. New stores have to make sense on the balance sheet before they make sense as brick-and-mortar locations.

Finally, measured expansion is key, according to Bieri—after all, 10 under-performing stores will result in much smaller losses than 100 or 1,000.

### Where are you going?

Fortunately, most chain retailers understand that every new lease constitutes a potential liability and could be the cause of the company's undoing, says Howard Davidowitz, chairman of Davidowitz & Associates, Inc., a New York City-based retail consulting and investment banking firm. The concept most firms start with when considering new locations is an attempt to replicate a chain's best-performing stores. To do that, retailers first have to know who their core customers are and where they reside. A lack of attention to its



**MITCHELL:**  
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core customer base might have been a reason for the demise of discount apparel seller Steve & Barry's, which filed for bankruptcy in July. According to a report from *Retail Traffic's* sister publication *Multichannel Merchant*, when Steve & Barry's set about collecting addresses from its customers for e-mail alerts, it neglected to ask them about their age, sex and income levels—something that should have seemed like Marketing 101 to any modern retailer. Instead, the chain, which grew to 276 stores over the past 28 years, went after the generous tenant allowances it was being offered by landlords with distressed properties. "They did not choose locations based on their ability to do business," says Bieri. "Their main goal was to get cash into their coffers."

How extensive customer research needs to be depends on the product the retailer is selling, but for most specialty chains an in-depth demographics model is a necessity, he notes. If the company in question is a large national or multinational operation, it will rely largely on its own management personnel to do the research, with some outsourcing to site selection firms such as Asterop, Inc., Pitney Bowes MapInfo, Nielsen Claritas, Buxton and others. For example, a retailer might collect the raw data from customers at cash registers or through Web sites, then hand it over to the site selection specialists for in-depth trend analysis. If the retailer in question is a start-up with a handful of established locations, it will often rely on consulting firms such as RCS, according to Mitchell. "It's cost-effective not to have an internal real estate department," she notes.

### Regional flavors

Once the core customer profile is completed, the retailer needs to identify specific markets within the country that feature a large concentration of those customers—again, an endeavor in which many turn to site selection firms for help. In the case of a chain that sells apparel or accessories, deciding to put new stores in the Northeast versus the Midwest could be a make-or-break decision, according to Davidowitz.

Residents in the Northeast tend to be more conscious of the latest fashions and spend a lot of money on clothes. Midwest consumers are more conservative and price sensitive, he notes. Davidowitz brings up the example of department store operator Macy's, Inc. buying St. Louis-based May Company. When Macy's brought in cutting-edge designs and did away with coupons at former May stores, the move proved to be a disaster, according to Davidowitz, because May's Midwest consumers were used to a different way of shopping.

After identifying potentially lucrative growth areas, the retailer needs to figure out how many stores it would need to open in order to saturate its new markets. "You've got distribution costs, advertising costs, district management issues, so what you are trying to do is build critical mass," says Davidowitz. It also needs to identify which retail properties are located in the area and how those stores fit into the retailer's existing image, adds Mitchell. Upscale teen apparel seller Abercrombie & Fitch, for example, would look only at upscale malls with a minimum of four anchors or street locations because it would not get enough foot traffic in a lower-grade property. Alternately, Mitchell says Chico's FAS, Inc. and Coldwater Creek, two apparel chains that serve middle-age women, have been suffering lately because both built their expansion models on locating in lifestyle centers, which don't get the same level of foot traffic as do regional malls or street locations, especially in a down economy. In the second quarter of 2008, Chico's reported

a total sales decline of 7.1 percent, to \$405 million, and a same-store sales decline of 15.9 percent. Total sales for Coldwater Creek went down 4.8 percent during the same period, to \$241 million, and its same-store sales declined 13.7 percent.

Scouring the ground for appropriate retail properties usually falls to the lot of the chain's regional real estate professionals, who often have intimate knowledge of their markets, or to a real estate consulting firm. When conducting that search, savvy retailers consider not only the format, quality and exact geographic location of the center, but also cannibalization risks and cotenancy possibilities, according to Mitchell. When RCS was building an expansion model for Bare Escentuals, a start-up cosmetics company that sells minerals-based, "natural" makeup, last year, it specifically targeted spaces next to Victoria's Secret and Coach stores, because they cater to the same customers Bare Escentuals is targeting.

The final and, arguably, most important piece of the puzzle comes when the company tries to align its expansion strategy recommendations with its capital availability, based on the required level of investment and sales projections. Here every minor detail counts, says Bieri. One real estate broker *Retail Traffic* spoke with told the story of a brewery restaurant concept that decided it wanted to open stores only in lifestyle centers, next to movie theaters and other upscale eateries. But the concept's owners never bothered to do the math on their expansion strategy. In the end, their economics did not work because of the higher rents charged at lifestyle centers compared to other types of properties. The chain ended up with only one location, in a center whose property manager granted it a rent discount because there was no time to look for an alternate tenant. "The landlord is losing money by leasing space to them," the broker says. "It would have been real simple to understand up front what they could afford before even going down the road of [specific] locations."

### On a losing streak

Sometimes, however, even well-thought-out expansion strategies fail because of unrelated factors, notes Davidowitz. He says that most national retail chains have extensive real estate networks, including company-wide heads of real estate, regional directors and managers of specific stores, and are very careful about opening new units. But when consumers start to cut back on discretionary spending, sales projections that were valid a year or two ago, when the new stores were being planned, go out the window and the entire model appears faulty.

"All our clients sit down and do the hard numbers. It goes like this: we build a 6,000-square-foot store, here's our investment, here are the sales we are going to do in the first, second, third year... So why are all these stores going out of business? When your sales start to go down all over the chain, suddenly the store that was going to have an excellent return is going down and all the decisions you've made are wrong."

To guard against this, Bieri recommends following the example of Costco, a supremely successful retail chain that has been very careful about large-scale expansion. The company's management has stated Costco can eventually grow to as many as 1,000 stores worldwide, but this year it will only open a total of 35. "The companies that have done a great job are those that are not in a hurry, that understand a store has to fit into a certain situation for them," Bieri says.