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# ELEMENTS OF CHANGE, STABILITY & UNCERTAINTY IN THE RETAIL REAL ESTATE MARKET

by Alan R. Winger

The threat of on-line shopping has been an unsettling factor in the retail real estate market for some time now.<sup>1</sup> While the recent problems of many "pure-play dot.com e-tailers" (e.g., Price line.com) may raise questions about just how serious this threat is, on-line consumer shopping continues to grow rapidly. And even though such e-commerce still only constitutes a relatively small proportion of the total, (slightly less than one percent), its continued growth, along with the sustained optimism of the technology guru about its future, continues to cast a shadow on investment holdings of the real estate that houses today's brick and mortar retailers.

Of course, those with a current vested interest in such real estate can take comfort in the fact that forecast of drastic economic change seldom if ever comes close to the mark. But things do change and some times dramatically. How and where we distribute consumer goods and services, for example, is substantially different today from what it was prior to the dominance of the automobile in our lives.

## ABOUT THE AUTHOR

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While one of the messages in this article is that it is safe to say that there is no depression in sight for most current investors in retail real estate, there is good reason to believe that change, and possibly significant change, is coming. While we don't know exactly how much and how soon, we do have knowledge and a broad understanding of some of the agents of change, (stability and uncertainty), likely to impact the movement of shopping into the virtual world. After spelling out these forces and how they are likely to influence retail real estate, some thoughts are offered about likely outcomes. To preview these, if the concern is with the next decade or two, technology gurus offer greatly exaggerated views about the likelihood of radical change in where and how we will

shop in the new economy. As we go further out in time, the prospect of significant change becomes more likely. While there are elements of stability in this market that will leave us with recognizable features even as we approach the middle part of the 21<sup>st</sup> century, there will be a lot that is different as we respond to the undeniable benefits of bringing our shopping decisions into the virtual world.

### **SOME BASICS: IT ALL DEPENDS ON SHOPPING BEHAVIOR**

What most retailers provide in the current setting is site utility. The space they use in creating that utility (or value) is the retail real estate, the market for which reflects a large array of factors that come into play in market supply and demand. While there are many elements in the retail real estate market equation, at rock bottom lies the shopping behavior of households.

Households, of course, make purchases based on what they want and what they can afford. The shopping experience is how they go about finding what they want at the price they are willing to pay. Retailing is—or should be—a concern in making this experience a success.

What households want when they shop is information, convenience, and a positive experience. The information needed is facts about prices and the qualitative characteristics of what they want to buy. Convenience reflects the ease with which the facts can be collected and a purchase made. Put in terms of costs, convenience is reflected in the time, transportation, and communication costs involved in the purchase. The shopping experience has to do with the socio-psychological elements in the act of purchasing. To some folks, this is more than just an effort to get what they want at a minimum cost. The experience is a part of what they do that gives life its meaning.<sup>2</sup> It is also something that provides them with opportunities to socialize with others, which is important to some.

The retail real estate market, if it does its job right, clearly does a lot for households. Precisely what that depends upon elements that underpin shopping behavior, which means if there is significant upcoming change in the role of retail real estate in getting goods to the final consumer, it will be the result of elements of change that impact this behavior. Pitted against such elements of change are those that engender stability and uncertainty. The outcome can be seen as coming out of the interplay of these three sets of forces.

### **FORCES OF CHANGE**

The big, current threat to the way in which existing retailers operate and hence the real estate they use, comes, of course, from our emerging information technology. Coming out of this technology—now concentrated in the development of the Internet—are economic benefits accruing both to the seller and buyer.

The economics here as they play out in business-to-consumer e-commerce bring forth a number of significant cost savings to the seller. The most obvious of these is the reduction in costs that comes from cutting out expensive shopfront operations as well as intermediaries when possible. Economies of scale and scope also come easier on-line in certain kinds of operations. Once a Web site is set up, the cost of its use in the pursuit of an additional customer, for example, drops to almost zero. And with successful customer contact, it is much easier and less costly to push other products and services. Web contacts also provide the basis for collecting and assimilating more information about the customer at a much lower cost than is now incurred in an off-line operation.<sup>3</sup>

From the viewpoint of the consumer, electronic linkages allow them to comparison shop in a less costly way. Moving around with the click of a mouse is much less expensive both in terms of travel cost and the time involved in moving from store to store.

The matter of time savings is particularly important to many families, in large part, because of the mass movement of women into the work force.<sup>4</sup> This movement, coupled with the growing importance of the extra-curricula activities of their children, has greatly increased the time pressures faced by parents. Large numbers of families now have less time to shop than did previous generations. While leisurely shopping (and the things acquired through the experience) can add to life's pleasures, it is no longer possible for many. Trips to the mall do not fit well into a schedule crammed with work as well as school and home-life activities. Trips to superstores or groups of "killer-ap" stores that make it easier and quicker to find what is needed is one consequence. Eating out more is another. And entry into the virtual world of shopping seems to be fast becoming another.

Of course, shopping in cyberspace is something that requires competence in navigation that many do not have; this means some ability to operate a

computer, which is not a skill possessed by all who shop. But it's one that many, especially the young, are acquiring. Furthermore, the skill requirements are being reduced as technology gives us more user-friendly ways to link up with the electronic networks that are the core element of cyberspace activity.

Clearly, the electronic shopping options that are developing provide shoppers with alternatives chucked full of economic benefits in a growing number of areas of consumption.<sup>5</sup> And the nature of these benefits seems to be important to a growing number of shoppers. Despite the recent problems of many "pure-play" operations, on-line shopping still appears to be an alternative that will, in time, become a dominant way to shop for many things. Or will it?

### FORCES OF STABILITY

While no one doubts the presence of dynamic forces in the current economic setting, change, while it can be fast-paced and radical, is more often slow-paced and evolutionary. Forces of stability usually abound. Such forces, as they impinge upon retailing, are not absent today.

One of these is found in demography. That the nation is aging in the sense that proportionately more of its population is falling into older age categories is a demographic fact likely to slow the movement of shopping decisions into the virtual world.<sup>6</sup> Older people, not surprisingly, have been much slower to acquire the skills needed to operate in cyberspace. The young now receive training in the early years of their schooling, most of whom quickly become comfortable operating in the virtual world. This training is not so readily available to the elderly, who, in any events, are less receptive to it. Older folks are thus less attracted to the potential benefits of e-shopping. This is not to say they will shun shopping in cyberspace. It is to say that the probability of their doing so will be substantially less than it is for the young. The elderly are a stabilizing force in the sense that their presence will restrain the growth of e-shopping. While this is restraint that, in time, will disappear, it won't happen for quite some time—a generation.

A second development likely to slow up the movement towards cyberspace shopping is the recent widening of the disparities of personal income and wealth. While our recent economic prosperity has enriched the coffers of many, it has failed to reach some. Consider just one brief comparison. In 1979,

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the median income of an American in the upper 5 percent of the income distribution was three times the median for the entire population and 13 times that of the median of those in the lower 5 percent of this distribution. By 1997, those in the upper 5 percent had incomes almost four times the population median and 23 times that of those in the lowest 5 percent. Since there are clear indications that the use of new information technology is income sensitive—use is much greater for higher-income groups than those with lower incomes—the way in which the economy is distributing the fruits of its recent glowing performance is slowing down the spread of its use. Those who have not been beneficiaries of the recent economic boom—and their numbers are considerable—are less likely to swell the ranks of those taking advantage of what e-shopping has to offer. They stand as an element of stability in the nation's retail real estate market as it exists today.

Finally, there is the matter of the people themselves. While there is constant change in what we do and how we do it, there is also stability in our behavior that reflects in what is often called human nature. This, as it turns out, is stability that shows up in behavior that has been and should continue to be a stabilizing force in the retail real estate market.

What we do, of course, is influenced by our environment, changes in which account for much if not most of the behavior changes we observe. As that environment is now changing to provide shoppers with a quicker and more convenient way to shop, we would expect them to respond. And respond they have. But the nature of that response is and will continue to be influenced by the human nature of the responder.

The concern here is with aspects of our make-up that have always been a behavior-determining factor. It is something, however, we have become more sophisticated about largely because of the recent work of neuroscientists, behavior geneticists, and evolutionary psychologists. Through their work,



we have come to see our behavior as something that is strongly conditioned by a mind biologically equipped with circuits that help us act and learn in intelligent ways. This is a mind that also comes with emotions that both contribute and interfere with our effective use of this equipment.

What we have in our biological make-up is something that has been inherited in an evolutionary way over many, many years. As it is reflected in our minds now, it is something that exerts a stabilizing influence on our behavior. It is stabilizing in the sense that it helps produce recurring behavior, one aspect of which is social propensity—the longing to be with family, friends, and communities. The emotions that underlie this propensity also embrace such things as jealousy, status-seeking, infidelity and mistrust. In short, what we call human nature—this socio-biological make-up of the person—underlies much of what we do that gives rise to a social world that is a cauldron of experiences which includes conflict as well as relationships of love and friendship. What we have is behavior that reflects the nature of people as they have evolved over thousands of years. Because it is so deeply engrained, it is behavior that is likely to be with us well into the future, which means the continued dominating presence of social relationships in our activities.

The important question as far as the future of retailing is concerned is whether these social relationships will continue to play themselves out in a face-to-face setting. Currently, there are obvious advantages to interacting with others on a face-to-face basis. It is clearly the richest form of interaction embodying as it does all the senses, logical discourse and a feedback mechanism that is both immediate and intimate. But some if not many of these advantages will disappear as our electronic connections begin to mirror more of what we can do in a face-to-face setting.<sup>7</sup>

#### *How will we respond to such changes?*

There is some evidence in the way in which the telephone worked its way into our everyday lives that suggests face-to-face communication will remain of some importance as electronic connections develop. While the telephone replaced some, if not many, earlier face-to-face interactions, it also greatly expanded the number of contacts or potential points of interaction. This in turn led to new social interaction in a face-to-face setting. And apparently it did, because there is something in the nature of the person that places a good deal of importance on such contact.

Significantly, that something seems to be present as the Internet works its way into our connections with others. While our electronic connections are rapidly expanding, this is not happening at the expense of face-to-face meetings. These seem to be holding up.<sup>8</sup> As the technology has developed thus far, there certainly seems to be good reason to expect that physical proximity will remain important in many of our social relationships, which implies some behavior stability that works to the benefit of retail real estate as we know it today.

#### **FORCES OF UNCERTAINTY**

One element of uncertainty in the current setting is the economy. While our strong economic performance throughout most of the 1990s helped fuel the rapid pace of innovation that gave us the ability we now have to shop in cyberspace, the continuation of that performance is by no means assured. While the innovation itself has been a part of the reason why there has been so much strength in the economy and what it has given us has eased some areas of cyclical vulnerability in the economy, few believe the business cycle is dead or that inflation and economic stagnation are problems of the past. Indeed, as we entered the year 2001, there were signs pointing to a possible cyclical downturn. Since we don't know exactly when the down times will come or how far down we will go when it happens, there are clouds of economic uncertainty out there, as there always have been. And the consequences of this uncertainty as far as the virtualization of household shopping is concerned are also uncertain. Concerns about a recession are likely to restrain movement into that world by reducing the incentive for the innovation needed to get us there. They could also make households more cautious in their shopping behavior, making them less likely to do things differently. But if the economic benefits turn out to be as big as some now say, the appeal of electronic shopping could increase in an era of uncertain economic times. Those in search of bargains, whose numbers would grow in the face of a prospect of economic hard times, could be attracted to the economic benefits of shopping in cyberspace during such periods. How all this might work itself out is unclear at this point, which means clouds of uncertainty will likely hover over future decisions made that could lead to more virtual world shopping.

There is also another more subtle source of uncertainty that could influence future shopping decisions in ways that impact retail real estate. It stems from the patterns of recent consumption that some

have characterized as obsessive.<sup>9</sup> As incomes have risen, allowing us to spend relatively more on discretionary items of consumption, many of us have taken full advantage of the opportunity and have done so in part because of innovative business efforts aimed at encouraging increased spending. There are a lot of businesses offering differentiated products they present as being much better than the competition. The emphasis in such offerings is usually not so much on the intrinsic characteristics of what is being offered, but on the experiences that come from consuming. There is nothing new in this. What is new is the extent and degree to which it happens. Much of what we now consume is being presented to us as something that will give us a better life in terms of the experiences that are important to us.<sup>10</sup>

In the current setting, many of us as consumers go after bigger and better packages of experiences which businesses have been more than willing to provide. While the age-old economic principle of diminishing utility lurks in the background as we behave this way, so far it hasn't slowed us down. Whenever our interest wanes, the market seems more than willing to provide that something bigger and better which, for a time, satisfies what we crave.

Obvious illustrations of such consumption can be found in entertainment spending. It shows up in trips to places like Disney World, Las Vegas, or exotic cruises. Our pleasure from such trips comes out of the experiences we have. And one very interesting feature about those experiences is that while they surround us with others, social interaction really isn't a big part of the experience. What is important are the experiences associated with the things that are a part of the physical environment and those things are there in abundance. What we are increasingly provided with in such settings are simulations of far-ranging parts of the world and life experiences that are presumed to be of interest. And electronics through computer technologies have made such simulations easier to produce in traditional sites of consumption. Witness what we are offered in major entertainment centers such as Disney World.

That we are able to produce bundles of experiences that are so appealing to the consuming household has led more than a few to believe that much retailing in the 21st century will be carried out in mega malls that will also serve as entertainment centers.<sup>11</sup> If this turns out to be the case, the retail real estate markets may be less affected by the

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emerging information technologies than many technology gurus now think.

But there is another side to this. If a growing proportion of our acts of consumption include less socializing as is now argued, why wouldn't it be possible to attract the consumer to electronic options if the experiences they're after can be simulated electronically in a way that is much less expensive?

There is no clear answer here to be found in our current knowledge and understanding of consumer behavior. What we have is uncertainty about how households will respond to what our innovative businesses will be offering them. And this just happens to be a response that could have important bearing on the future shape of the retail real estate market.

#### **WHAT DOES IT ADD UP TO?**

There can be no disputing the fact that there is the potential for big economic benefits in electronic shopping compared with the way we do it now. If that potential is realized, there could be significant changes in the way we shop, changes that could radically alter the way in which we get goods and services to the final consumer.

But will this happen? There are two answers to this question: 1). "No," if the concern is with the next decade or two; or 2). The other is probably "yes," if the concern is with the years that lie beyond 2020.

#### **THE NEXT 20 YEARS**

There are several reasons for believing that electronic shopping, while it will continue to grow over the next 20 years, will remain small relative to the total. The first of these is that generational matter. The technology, no matter how user-friendly it becomes, is likely to continue to meet with resistance by the elderly who are a growing part of the nation's population. While this is something that will gradually disappear, it won't happen overnight.

Second, there is the matter of economic uncertainty. If the business cycle is not dead, as certainly appears to be the case, there will be economic uncertainty that will reduce the incentive for the innovation necessary for the infrastructure needed to get masses of people into the world of virtual shopping. Over time, there will be periods of economic prosperity that foster such incentives, but with clouds of economic uncertainty overhead, the process of getting what we need will take longer than some now believe.

Finally, there is the matter of working the bugs out of what will be forthcoming to get us where we want to go. Assume we are able to incorporate into our electronic connections much of what we are now able to do in a face-to-face setting. It's not going to be easy getting there. We already have some sense of this in the inventory and delivery problems encountered by early e-tailers. Traditional retail means of storing and moving goods out of inventory do not work when the concern is with individual items going to individuals. And deliveries of those items to households who are absent from home much of the time is not easy to do. While these are problems that are being resolved, they are only the tip of the iceberg. There will be a number of bumps encountered on the rocky road that will take us to where the visionaries tell us we are headed. Assuming we get there, it's going to take at least a decade or two. All this implies some stability in our retail real estate markets over the next 10 to 20 years, even if radical change is on the way.

## BEYOND 2020

There is certainly reason to argue that the retail real estate landscape will change—probably substantially—just as it did when the automobile came to us. Those anticipated economic benefits from electronic shopping will surely bring this about. But it is also likely that there will remain recognizable elements in that landscape, just as there are features in today's world that no doubt look familiar to those who remember what it was like prior to the automobile. Human nature being what it is, there will be some continuity in where and how we distribute what we consume.

How the technology develops will have important bearing on our shopping behavior. Just how much we are able to mimic what we can do now face-to-face will certainly influence the extent to which we become cyberspace shoppers. While many of the current advantages of "being there" when making a shopping decision are going to disappear, we

don't know exactly what *many* means and we certainly don't have a stellar record of forecasting the technical consequences of changing technologies.

How we behave as consumers will also have bearing on the outcome. While human nature, being what it is, will work to keep some shopping out of the virtual world, how much inertia it creates will depend partly on how we respond as consumers to the bundle of experiences that firms will be giving us. The uncertainty here is just what experiences or packages of experiences will turn out to be most attractive to us.

Excursions into a fantasy world have been growing, most of which have been taken in places outside cyberspace. Such shopping augurs well for retail real estate as we know it today, even though the location and scale of such retailing may change in the future. But such excursions are becoming increasingly possible in the world of cyberspace at a much lower cost. It's hard to conceive of most of us turning away from the virtual opportunities we will be offered. While human nature, as we know and understand it, will limit the amount of such pursuits, cyberspace in-roads will be made. And significant gains, say by the time we reach the middle part of the 21<sup>st</sup> century, are possible.

## SOME FINAL THOUGHTS

Just as the automobile brought about radical change in how we go about shopping, so will those electronic network connections we are now building. By the second half of the 21<sup>st</sup> century, the majority of our spending on consumer goods is likely to involve an electronic connection in one way or another. But what all this will mean with respect to how what we produce gets distributed to the consumer is not so clear. Shopping will not simply be a matter of making decisions electronically at home with direct deliveries there. While this kind of shopping will grow increasingly important, it won't totally dominate our shopping behavior. Trips to places that provide entertainment as well as shopping opportunities for certain kinds of consumption will not disappear. Human nature and the continued increases in the sophistication of the simulations of experience that will be possible in real world settings will continue to keep many of us shopping for more than a few things in "traditional" ways — ways that involve real estate as we know it today. While these ways will become less important—maybe much less important—they won't disappear.



For those with an interest in investment possibilities in the current retail real estate market, these broad-brushed statements of what it could be like 50 years from now might seem something less than relevant to what are taken to be more immediate and pressing concerns. We are talking now about developments and changes that won't happen overnight. If our time horizons only take out a decade or two, aren't these matters that will only clutter up our view of what's important in the investment decisions we make? Isn't this something that might be best ignored?

Perhaps; but it is well to remember that the dynamics of the retail real estate market are changing now in ways that are not fully understood. Stretching the mind by venturing our thoughts further into the future can help us think better about the things that might be relevant to these unfolding dynamics. Change, perhaps radical change is coming. There is time to prepare for it. But successful preparation requires a solid understanding of the underlying dynamics of the market. *Now*, it would seem, is the time for those who study this market to initiate the research that will lead to such an understanding. And a good place to start might be with a careful review of a framework set forth by Evans and Wurster in their effort to explain how the new economics of information is transforming the strategies of many businesses including those in retailing.<sup>12</sup> REI25

## NOTES

1. L.W. Fiedler and N.M. Weisenberger raised the issue back in the early 1990's in their article "Will Neighborhood Shopping Centers Be extinct by the Twenty-First Century," *Real Estate Review*, Summer 1994, 45-49. More recently, Frank Feather added fuel to the fire in his view of the future shopping behavior of households as it impinges upon the distribution of consumption goods. See F. Feather. *The Future Consumer*. Toronto, Canada: Warwick Publishing Group, 1997.
2. See D. Miller. *A Theory of Shopping*. Ithaca, N.Y.: Cornell University Press, 1998 and S. Miles. *Consumerism as a Way of Life*. Thousand Oaks, CA: Sage Publications, 1997.
3. For a more detailed discussion of these economics in what *The Economist* calls "webonomics," see "Shopping Around the Web: A Survey of E-commerce (Special Supplement), February 26, 2000, pp.6-15.
4. The labor force participation rates of women more than tripled between 1960 and the end of the 20th century. For one description of how the life style of many two-income families has changed and how this is altering their shopping behavior see "Once Upon a Time Understanding Consumer Motivations Seemed So Simple." *American Demographics*, January, 1999, pp.61-65.
5. Currently, the benefits are greatest in areas where the product can be delivered over the Internet such as computer software, airline tickets and financial services. Items that consumer prefer to see and touch before they buy such as fruits and vegetables, clothes and shoes are much slower in

getting into cyberspace. The visionaries see ways in which this can happen, however.

6. In 1999, people 55 and older made up 21 percent of the population. By year 2010, that proportion increases to 25 percent.
7. For one view of how the technology might evolve see M. Dertouzos. *What Will Be: How the New World of Information Will Change Our Lives*. New York: HarpersEdge, 1997.
8. See W.J. Mitchell. *e-topia*. Cambridge MA: MIT Press, 2000, Chapter 6.
9. Obsessive is a judgmental term often found in sociological tracts concerned with consumption. See for example G. Ritzer. *Enchanting in a Disenchanted World: Revolutionizing the Means of Consumption*. Thousand Oaks, CA.: Pine Forge Press, 1999.
10. See B.J. Pine and J.H. Gilmore. "Welcome to the Experience Economy." *Harvard Business Review*, July-August, 1998, pp.97-105.
11. See M.D. Beyard, et. al. *Developing Urban Entertainment Centers*. Washington, DC: Urban Land Institute, 1998.
12. See P. Evans and T.S. Wurster. *Blown to Bits: How the New Economics of Information Is Transforming Strategy*. Cambridge, MA.: Harvard Business School Press, 2000.