

Promises to keep

By Diwakar Kumar

REAL ESTATE IS THE LARGEST COMPONENT OF COST FOR A MODERN RETAILER IN INDIA. AT AN AVERAGE OF 15 PER CENT OF SALES BEING PAID OUT AS RENTALS – COMPARED TO 2-3 PER CENT OF SALES IN DEVELOPED MARKETS – JUST THE RETAIL SPACE COST IS ENOUGH TO SERIOUSLY DENT A LOW-MARGIN RETAILER'S BOTTOMLINE. HOWEVER, IS REDUCTION IN RENT THE PROVERBIAL FINAL SOLUTION?



→ No wonder then that the predominant demand of retailers from developers/mall owners in recent months has been some rationalisation in rental payouts. And this phenomenon is not limited to India, by any means. Anywhere in the world, the perennial complaint – especially of small retailers -- is that rents are too high and this causes profit margins to be too low.

One possibility is just to build a lot more shopping centres. The resulting oversupply will put downward pressure on occupancy and rents. The downside to this theory, is however, that sales densities will suffer as well, and that obviously does not help matters.

Falling rent is clearly good news for a variety of reasons, including the fact that retailers – big and small – are able to access previously unattainable locations at affordable rates. Look at the current retail space environment in USA, for instance. Retailers of all stripes now find that (arguably) the finest urban market in the world – New York City – is now affordable – and habitable. Just in the past three months, major US chains have opened outlets in Big Apple's boroughs, including at the prized Manhattan.

On July 31, JCPenney opened its first Manhattan location at the Manhattan Mall. Later this year, Costco is scheduled to open its long-awaited store in East Harlem at 116th Street at East River Plaza. Joining Costco there is the inaugural location for Target. Meanwhile, Nordstrom has announced it signed a lease to open a 32,136 sq.ft Nordstrom Rack, the company's discount retail format, which will open in spring 2010.

In the Indian context, retailers point out that due to the flux in sales figures, it becomes a little annoying to



follow the pure rental format. Many retailers have therefore already chosen to exit unviable locations, including those at malls. In fact, Cushman & Wakefield report says malls across the country saw high vacancies in the second quarter of 2009 when the country was still feeling the after-effects of the global meltdown. Ahmedabad, with one of the highest perceived per capita incomes in the country, also recorded the highest mall vacancy rate at 39.4 per cent, according to the report by the real-estate services firm.

The average vacancy across malls in major cities of India increased from 10 per cent in the first quarter of 2009 to 19 per cent in the second quarter due to a slowdown in the uptake of mall space and churn amongst the existing clients, according to the report. This increase in the vacancy was critical in bringing about further correction in the mall rentals.

Naturally, a correction is followed by re-negotiations. Enter the 'Minimum Guarantee Scheme' (MGS) and revenue sharing. Properties such as Inorbit, Forum Value Mall and Select CityWalk in Delhi have reportedly shifted to a combination of minimum guarantee and revenue sharing models, accompanied by a performance clause in the agreement. Clearly, such flexible revenue models are acceptable to the retailers as the risk is shared between the real estate owner and the retailer. Also, it makes the developer more accountable for generating footfalls and conversion rates in the mall, while reducing the risk of high vacancy in the mall.

Now comes the rider – for such models to take effect, retailers will have to disclose sales figures. Is that completely possible?

Devangshu Dutta, chief executive of Third Eyesight says, "If retailers want a variable rent rather than a fixed figure, and if they want mall developers to 'share the risk and the reward', they absolutely must share sales figures."

He further adds, "However, if confidentiality is a concern, then the only option remaining is to decide a rent that is viable for both. Problems include the high prices at which the land has been acquired, the lack of adequate demand mapping which has resulted in over-clustering of malls and overpricing at launch, and overall dampening of demand in the last couple of years. Both sides will have to look beyond the immediate transaction – of course, that is only possible if each company has the cash and the power to sustain through this temporary economic situation."

"A minimum revenue sharing/guarantee module implies that a partnership exists between the retailers and mall developers. Such a partnership cannot thrive on any platform other than trust," says Anuj Puri, chairman & country head, Jones Lang LaSalle Meghraj.

"If any retailer does not deign to divulge sales figures to the developer, such a partnership cannot exist; a flat rent would then be the only solution. This yardstick would be applicable for all retailers who do not disclose their sales figures, while the revenue sharing/minimum guarantee module would continue to apply for those retailers who do," he adds.

"The backbreaking rentals of commercial space has been a little tough to bear during slowdown. Confidentiality is a major issue, but to make the centre a true shopping destination, tenants have to work hand-in-hand with developers and we (tenants) have to be transparent while sharing our true sales figure with the developers," admits Ajit Joshi, CEO & MD, Infiniti Retail Limited (Croma).

"As developers, we ensure that a good mix of right brands offering value products and quality service to the customers is made available in the retail space. As a norm, retailers need to share the sales figure with the developers which helps us in accessing the performance of the mall. In order to drive footfalls to the stores, various mall events are designed which directly provide boost to their sales," underlines Vikash Oberoi, MD, Oberoi Construction Pvt Ltd.

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chief executive of Third Eyesight.

"I don't think the minimum guarantee rent concept is transparent enough to work when there is always a very high possibility of getting disputes of not disclosing the right sales figures," underscores Sunil Sanklecha, managing partner of the Chennai-based supermarket chain Nuts 'n' Spices while dismantling the case for this model.

"From the tenant point, yes, I would see advantages, but from the developer's perspective, they'll always entertain doubts about the accuracy of figures shared. My belief is that the retail environment in our country

is not mature enough to work with such a concept. The idea is definitely brilliant -- provided the tenant and the developer are honest and transparent, so that there is a win-win situation for both."

"At Future Capital Real Estate we always believe in the relationship between us and the retailers. In case the right store sales figures are not shared, the relationship shows signs of strain and it is likely that the minimum guarantee numbers then tend to become so high that they almost seem like pure rental numbers," says Joanna deSouza, president, Future Capital Real Estate.

"In the Indian market, where the trend seems to be progressing in the right way, incorporating revenue shares into the rental structure, it will become very apparent in the close-knit circle of developers, the names of those retailers who circumvent from sharing the right figures. Those retailers in the long run will realise that they are being offered pure rental deals as opposed to a MG/revenue share deal. Hence in the retailers' long-term interest, it is best that they

are upfront right from the start and work hand-in-hand with the developer to make the mall a more successful shopping destination," she adds.

"If retailers don't share their mall store sales figures with developers, then minimum guarantee (MG) as rent cannot be implemented, because MG can only be fixed if there is a component of revenue share also in the agreement. You would notice that the agreements would say rent is payable as per 'MG or revenue share whichever is higher'," says Ravi

Pahuja, VP – operations, Odyssey India Ltd.

"Now, if retailers are not willing to share the sales figures, there is no way a developer can calculate the revenue share payable to him from the retailer's side. Hence in this kind of scenario the understanding between retailer and developer can be a rent-only, which in today's scenario is not a win-win situation either for retailer or developer," he points out.

"In the absence of an MG-revenue share model there would be endless discussions between retailers and developers to fix the rentals, which in turn can lead to delayed projects for both parties."

"The development of a retail

figures with the mall developer rather than just paying minimum guarantee," he notes.

Viney Singh, MD, Max Hypermarket India Pvt Ltd, says, "A revenue share arrangement by definition means that there has to be transparency in sharing of sales data between retailer and developer. If a retailer does not want to share sales figures, this cannot work. In which case a straight rental model is the option to follow."

Commenting on maintaining integrity of a revenue-sharing relationship, Rahul Vira, director, Gitanjali India Ltd, says, "The sanctity of numbers shared is very critical. The sharing of sales numbers has clearly to be done with a purpose and trust

between both the partners."

He further adds, "If the data shared is used for purposes other than those required, it is not in the right spirit. The business generation from a particular mall is as much responsibility of the brand as much as the developer. Therefore the right spirit of doing great business is critical."

According to Vira, minimum guarantee is definitely not the

way forward. "A retailer may not have problem in sharing the numbers as long as it is benefitting the retailer as well as the mall," he concludes.

Hence, the compelling requirement to resolve the ongoing dispute between developers and retailers is to cobble up a deal by enforcing the scheme of minimum guarantee to ensure that both sides are protected against the slowdown woes. ❌



business involves drawing consumers to a mall and creating customers at the store. Both mall developers and retailers need to work together to effectively build traffic and convert them into customers," opines Bijou Kurien, president & CE, Lifestyle Vertical, Reliance Retail.

"The revenue sharing model spreads the risk among both stakeholders and creates a common objective. In the light of this common objective, retailers, especially modern retailers, would be willing to share revenue