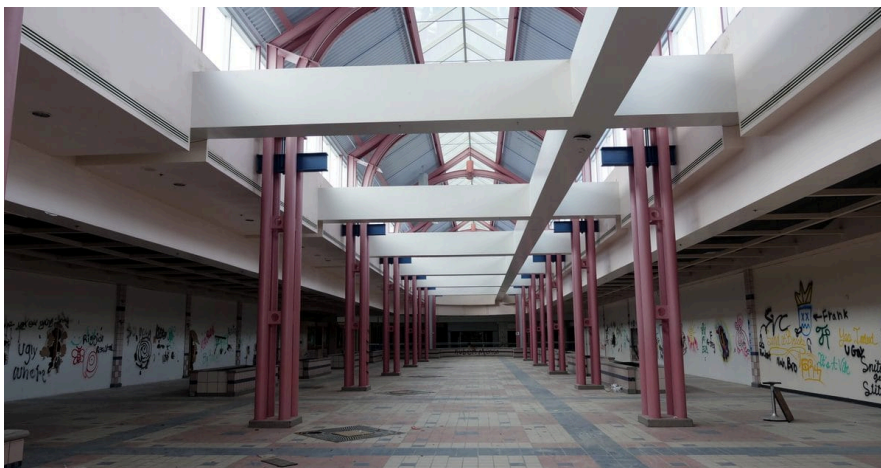


PUBLIC NOTE

How Will the Retail Apocalypse End?

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Before the pandemic I offered [five ways](#) to explain the “retail apocalypse” without referencing e-commerce. This time I’ll give you one more that ties them all together, and connect it all back to the internet and the standard digital narrative.

Because that narrative is not exactly wrong, but it’s incomplete. And it’s becoming too much of a consensus to be predictive or actionable in a business sense. Saying the pandemic will “accelerate” everything doesn’t get us much further.

So the new factor I’ll start with this time is **colocation**: why do different retail tenants locate near each other?

You could explain why they *need* to be near each other in terms of demographics, zoning, traffic patterns and so on. But I’m talking more about the micro level of cotenancy and cross-shopping: why do they *want* to be with certain neighbors and not others?

We can think of those reasons on a spectrum between complementary and competing uses. Complementary tenants are selling different products or services to an overlapping customer base, like a hair salon next to a supermarket. At the other extreme would be something like a jewelry district, with direct competitors clustering together to facilitate comparison shopping. And many tenant combinations fall somewhere in between — like a restaurant row, or a specialty grocer next to a traditional one.

Note that while comparison shopping is mostly good for consumers, it’s a double-edged sword for retailers and brands. They think it feeds an “addiction to discounting” and a race to the bottom. Their ideal would be to lock in their

customers and not have to compete for them at all. And this is what the digital / “omnichannel” story really offers from a retailer’s perspective: the prospect of using targeted distribution and marketing to compete less on product or price.

So with that in mind, let’s take this cotenancy framework and revisit those five factors I described in 2019:

1. OBSOLETE FORMATS

Historically the most important “comparison clusters” have been in fashion, and not just because it’s so conducive to in-person comparison. There are also strong complementary elements — apparel / accessories, women / men / kids, formal / casual — and a potent mix of necessity, aspiration and impulse.

For a while the most powerful fashion clusters were at malls, which were designed to take maximum advantage of all this. They’ve always had non-fashion tenants, but fashion comparison clusters were the glue holding it all together.

The “omnichannel” strategy that most retailers are adopting is like a solvent weakening that glue. It may have a “role for the stores to play,” but it’s less important for them to be in these expensive clusters. And it’s a lot easier for landlords to expand those clusters than to shrink them.

So the next time you hear about a dying mall that’s “reinventing” itself by replacing fashion with food and entertainment, imagine a beehive where you slowly turn off the pheromone trails that keep the bees working together, and start introducing other insects. Have you “reinvented” the beehive? It may look that way while there’s still honey and dead bees for the new tenants to eat, but then they’ll move on.

2. CONCENTRATION OF SPECIALTY SALES

Whatever it does to margins, comparison shopping has at least some leveling effect on sales across retailers. And from a landlord’s perspective, this is a virtuous cycle that keeps rents high. So when sales become concentrated in a few hot tenants, it’s another warning sign that those pheromone trails are fading and the tenants aren’t benefiting as much from being near each other. Beyond a certain point the winners won’t have to pay higher rents, and the other tenants won’t be able to.

That’s especially true if these winners are non-fashion tenants. So in this context, the rise of Apple stores as mall saviors was really a flashing red warning light. And when investors back out the Apple and Tesla sales in underwriting a mall, they’re still not accounting for the full risk of growing variance in sales across the tenant base.

3. GENERALISTS TAKING SHARE

So far this story sounds pretty bad for malls and outlet centers, but good for smaller open-air centers with a more complementary and convenience-oriented tenant mix.

And it is good for them. Even their key discretionary tenants tend to be the ones still offering comparison shopping within the store (like Ulta or TJ Maxx) as malls offer less of it.

But there's a problem lurking here too. Every thriving small tenant next to a Walmart is a chance for Walmart to add a department or service. To some extent this is also true for supermarkets, drugstores, and dollar stores. And they're all getting better at leveraging their captive traffic and economies of scale to capture a larger share of wallet from their customers.

The pandemic gave these generalists even more of a traffic advantage because of their "essential" status. It also drove faster adoption of curbside pickup, which further weakens the ties of coterminancy — not only by keeping all that potential cross-traffic in their cars, but by increasing the competition between tenants for parking and access.

So it's not a surprise that more value in these centers is flowing into net lease structures, shadow anchors and standalone stores. And in real estate terms, these single-tenant investors can get closer to that bedrock of zoning and demographics. But in the long run even they won't be completely immune to this turning-inward trend — because their locations often derive some value from being in larger retail agglomerations, where they'll compete with other vacancy at renewal.

INTERMISSION

Now that we've confronted these problems head on, we can start to answer our title question. When will the store closures stop?

It's not just about reaching the "right" mix of online and offline sales to satisfy some new set of consumer preferences, or getting down to the right amount of space per capita. Retail landlords are selling traffic as much as space, which is to say that they're selling different retailers' customers to each other. And as long as retailers are becoming less interested in sharing their customers, that service is simply going to be worth less at the average location.

So if you're a believer in the consensus narrative where this increased customer targeting goes on indefinitely, then you may be even more bearish on physical retail than you think.

But is that narrative true? Are consumer convenience and loyalty marketing really just two sides of the same coin?

Not always. Often they're in direct conflict. And even where they do fit together, that's not a stable dynamic.

4. FORGETTING HOW TO SELL

One paradox of digital marketing is that even as the ads and emails become more targeted, their content is becoming less differentiated. Competing brands have always copied each other and jumped on the same trends — but it's now harder to tell apart each new “athleisure” brand than it was to tell apart the teen retailers in a mall thirty years ago. What happened?

There's another comforting lie at the heart of this digital marketing gospel. We don't actually want completely “personalized” messaging, even if we think we do. Human nature is not to stand out from the crowd alone, but to find the right higher-status *smaller* crowd to join. And physical cotenancy forced retailers to define these different identities that they stood for.

But in the digital world they're adjacent to everyone and no one at the same time, and their “data driven” marketing won't let them draw clear lines that could rule out a marginal customer. So each new brand or product line converges on the same vague lifestyle markers and the same diffuse psychographics. And you see their Instagram ad and think “oh, another Lululemon clone” and keep scrolling, and can't even remember their name a week later.

5. SHRINKING BRAND LIFESPANS

Now we can see how the ongoing “reinvention” of many legacy brands is really a kind of gentle euthanasia, and all this targeting can become a trap. If every brand “reinvents” itself with exactly the same aesthetic, it will only get harder for them to retain these customers they're pushing online — where the next “digitally native” clone is always just a click away.

And physical retail can be an escape hatch from this online death spiral, if only as a matter of physics. No one can put up a new store next door as quickly as they can buy the next ad on your phone. And in a store we have to look up from our phones at least occasionally just to avoid bumping into the walls. That's not a guarantee of sales, but at least it's a chance to make a real impression.

In the short term, this can perpetuate a “clicks to bricks” mentality that simply extends the digital targeting fantasy offline, using stores purely as distribution and customer acquisition tools. But as retailers start to sign longer leases and think about the actual shopping experience, they'll become more interested in their neighbors again.

CONCLUSION

This isn't a TED Talk, and it doesn't end with a big idea. I haven't introduced any new jargon or theories, or told you anything you can't observe for yourself. But what I've tried to do is replace a single linear trend with five cyclical ones that offer more space for differentiated investment strategies.

So just to take #1 (formats) as an example: if new fashion comparison clusters re-emerge as malls collapse, where will they be? There's not enough room for them at the supermarket-anchored neighborhood and community centers that are attracting the most capital. Is this a reason to bet on out-of-favor lifestyle centers, or larger power centers that could accommodate more small-shop space? Is it a reason to take a fresh look at urban downtowns where pedestrian malls and other renewal efforts have failed in the past? Or at the mixed-use RFPs around suburban train stations?

If you'd rather bite the futurist bullet and say that the kind of in-person comparison shopping offered by malls and department stores is simply never coming back, I would disagree but there are plausible scenarios there too. For example, maybe some tech breakthrough like cheap 3D printed garments will make online comparison shopping more practical.

But in the meantime, these cycles are a better description of how retail has always worked. No one can permanently escape from competition, online or off, and every successful strategy is planting the seeds of the next counter-strategy.

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