Xymax Real Estate Institute
RESEARCH REPORT

Fact-Finding Study on the Opening & Closing of Commercial Outlets 2017

Findings from questionnaires and interviews with commercial operators

September 29, 2017

In partnership with the laboratory of Professor Yukio Komatsu of the Department of Architecture at Waseda University,*1 Xymax Real Estate Institute (hereinafter, "Xymax REI") conducted a questionnaire survey and interview with commercial operators (hereinafter, "operators") that operate or control multiple stores*2 on the opening and closing of commercial outlets. This report is a summary of the results.

The opening and closing of stores are the core element of operators' businesses and one of the most important real estate strategies. However, there are few quantitative analysis researches on the actual situation of operators' store openings and closures over a wide range of industries.

This report is a basic survey to uncover the actual situation of operators' store opening and closing strategies. We hope it would be useful data for investors, facility owners, and land owners in managing their properties and formulating operation policies, as well as for operators' store opening and closing strategies toward the future, amid accelerated changes in the environment surrounding commercial outlets.

*1 Laboratory of Professor Yukio Komatsu, Department of Architecture, Waseda University: http://www.waseda.jp/sem-ykom/
*2 Survey targets: Retailers, restaurant operators, entertainment providers, and service providers with net sales of 3 billion yen or more for the latest fiscal year surveyed by Tokyo Shoko Research (an overview of the survey is provided at the end of the report).

Key Findings

- Regarding the policy of owning or leasing real estate (land, building) upon store opening, 32% of operators replied that they did not have a particular policy. Operators respond flexibly for each property according to the policy of the owner or lessor.

- Upon opening a store, operators placed priority especially on the “area,” “market size,” and “rent and CAM (common area maintenance) fees.” Common problems upon store openings included “inability to secure employees” and “few properties match the appropriate size of the store.”

- 45% of operators replied that they had “cancelled a lease contract before expiry and closed the store.” The top reasons for the cancellations were external factors such as changes in the market environment.

- Social and economic factors that stood out as affecting future store opening and closing strategies were “an aging society, population decrease, concentration of population in urban centers” (90%) and “increase in personnel, distribution and other costs due to labor shortage” (84%).

- The survey results and interviews with operators indicate that there is a discrepancy between the business cycle of stores and the contract period (too long, too short).

1. Industry and Outlet (Profile of Respondent Operators)

The most common industry/category of the operator's core business was retail (food and non-food) (**Figure 1**). The percentages of the industry or category were roughly the same as the industry/category percentages of all operators to whom we sent the questionnaire. As for the number of directly-operated outlets in Japan, many operators in the restaurant and service industries operated more than 50 outlets (**Figure 2**).

Figure 1: Industry/Category of Core Business (Single Answer; n=586)

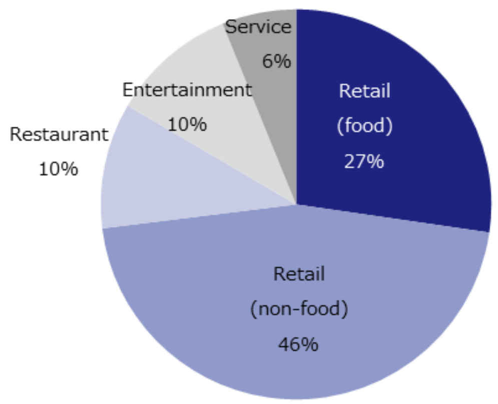
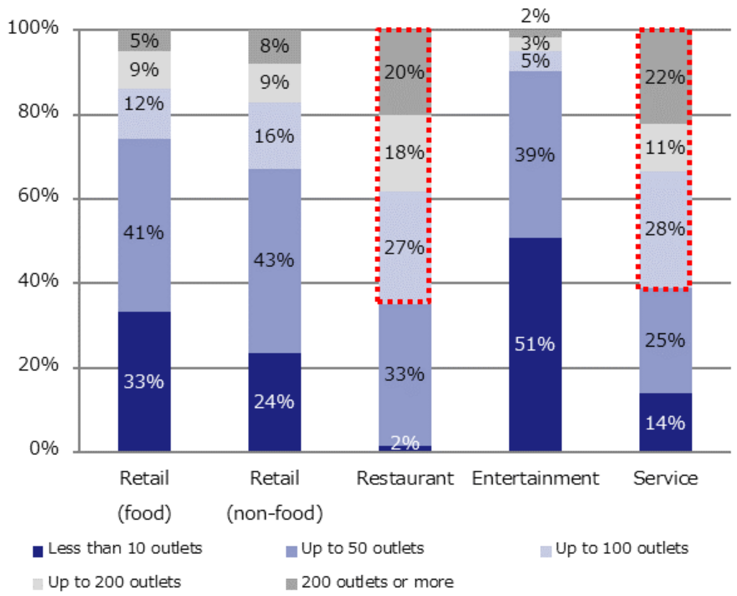


Figure 2: Number of Directly-Operated Outlets in Japan (Single Answer; n=583)



Asked where outlets were located in terms of the eight area segments of Hokkaido, Tohoku, Kanto, Tokai, Hokuriku/Koshinetsu, Kansai, Chugoku/Shikoku, and Kyushu/Okinawa, 75% of operators in the retail sector (food) were community-based, with outlets located in one area (**Figure 3**). The size of a standard outlet was small among service and restaurant operators, with more than 90% replying it was 150 tsubo (1 tsubo=3.3 sqm) or less (**Figure 4**).

Figure 3: Area of Directly-Operated Outlets (Multiple Answers; n=583)

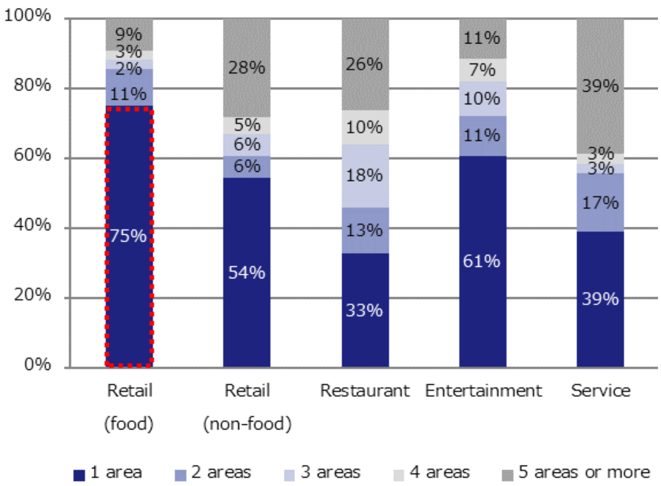
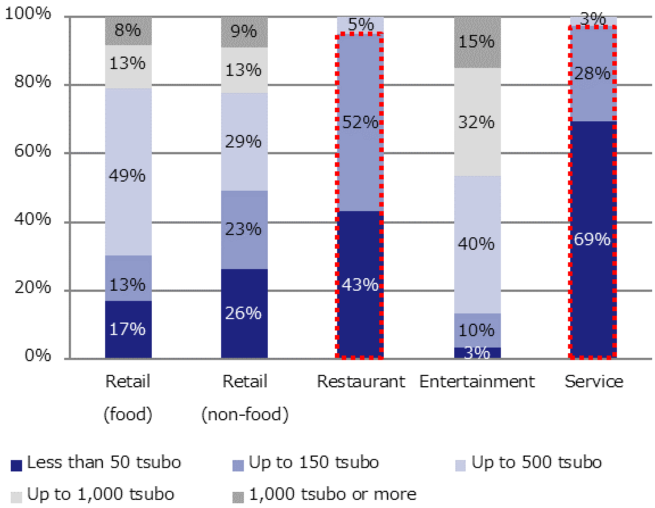


Figure 4: Size of a Standard Outlet (Single Answer; n=577)

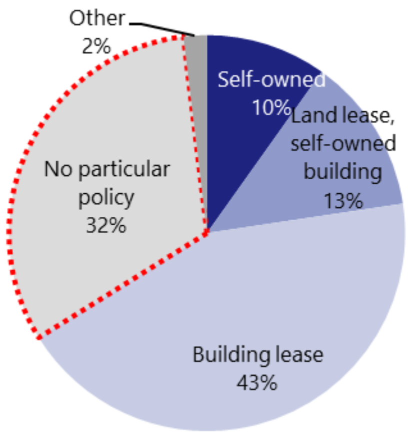


2. Contract Type

2-1. Policy of owning or leasing

The most common policy of owning or leasing real estate (land, building) when opening a store was "building lease" (43%), followed by "no particular policy." (32%). This implies that many operators responded flexibly for each property according to the policy of the owner or lessor (**Figure 5**).

Figure 5: Policy of Owning or Leasing (Single Answer; n=579)



With regard to the policy of owning or leasing, the more outlets the operator had, the more the operator made it a principle to lease the building (**Figure 6**). Operators with smaller outlets had a higher percentage of "building lease in principle." Operators with larger store sizes tended to have a policy of owning the property (**Figure 7**).

Figure 6: Policy of Owning or Leasing by Number of Outlets (Single Answer; n=571)

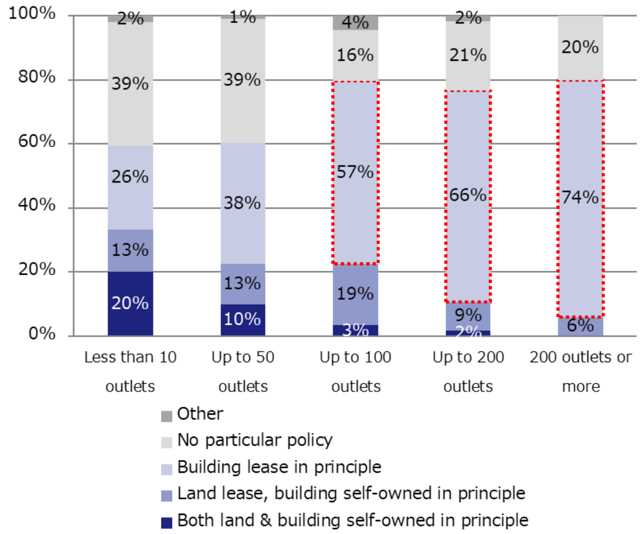
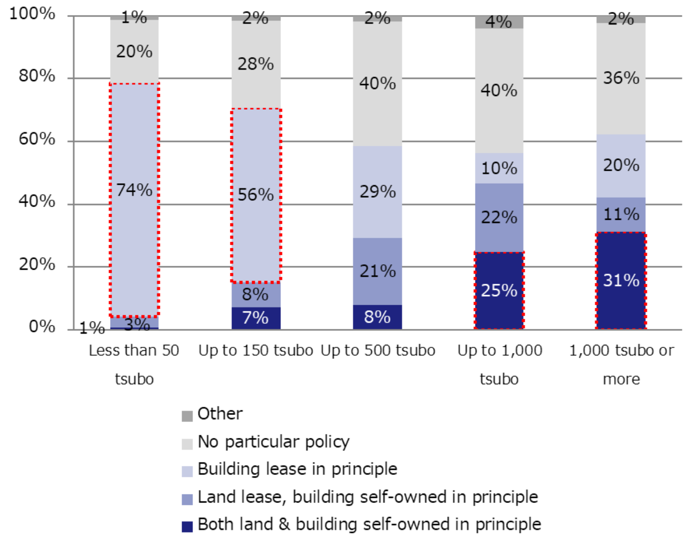


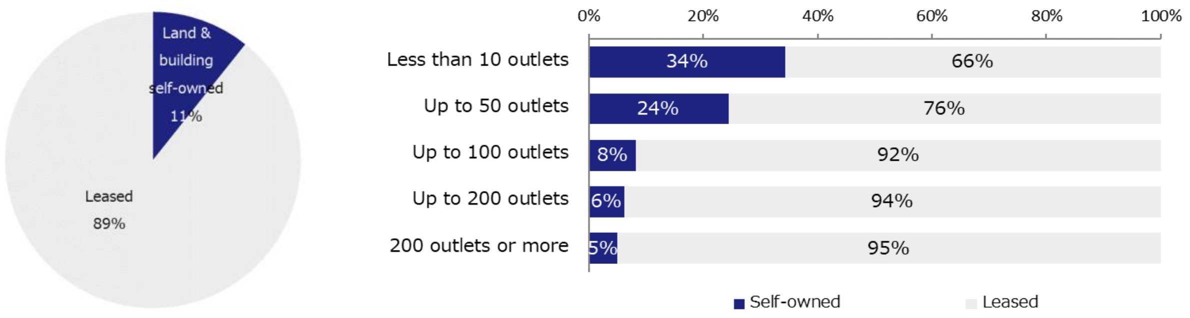
Figure 7: Policy of Owning or Leasing by Size of Outlet (Single Answer; n=577)



2-2. Current ownership and contract type

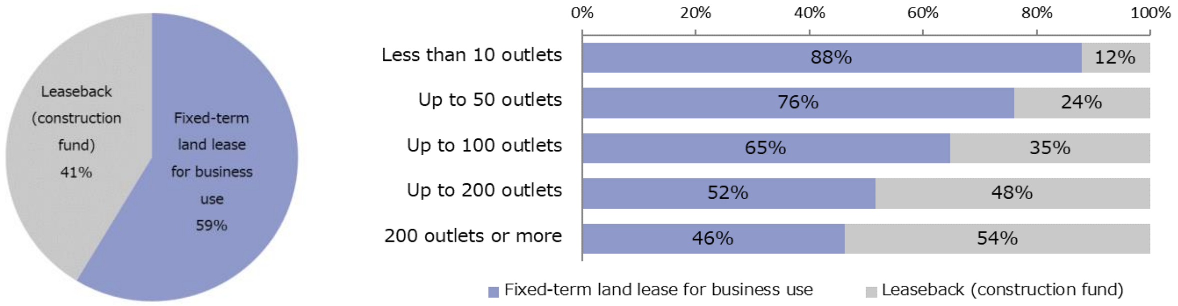
As for the ownership and contract type of existing outlets, the percentage of the estimated number of outlets[*3] that were self-owned was only 11%. A large majority was leased. Operators with fewer outlets tend to own their outlets (**Figure 8**).

Figure 8: Current Ownership and Contract Type; Self-Owned (Multiple Answers; n=578)



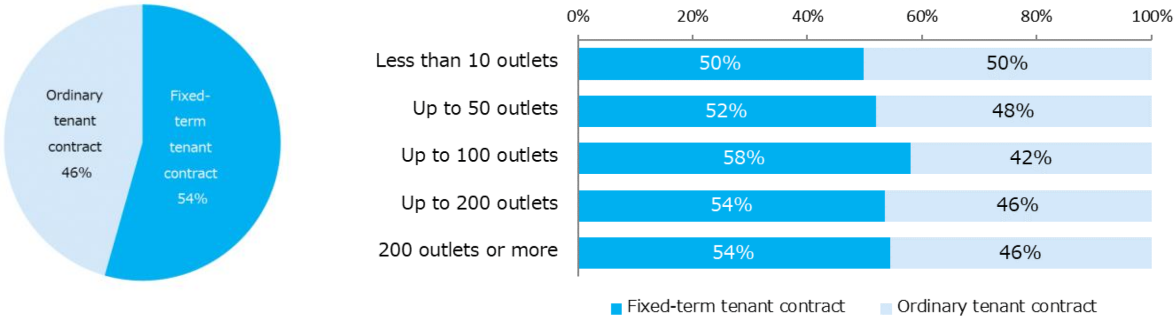
Furthermore, the percentage of the estimated number of outlets based on a "fixed-term land lease for business use"[*4] and on "leaseback (construction fund)",[*5] the major business frameworks when building a structure on vacant land, was larger for fixed-term land lease for business use (59% vs 41%). The percentage of "leaseback (construction fund)" tend to increase among operators with more outlets (**Figure 9**).

Figure 9: Current Ownership and Contract Type; Fixed-Term Land Lease for Business Use, Leaseback (Construction Fund) (Multiple Answers; n=578)



Among building leases, the percentage of the estimated number of outlets based on a "fixed-term tenant contract" and on an "ordinary tenant contract" was larger in fixed-term tenant contracts (54% vs 46%). There was no clear difference between the number of outlets of the operator (**Figure 10**).

Figure 10: Current Ownership and Contract Type; Fixed-Term Tenant Contract/Ordinary Tenant Contract (Multiple Answers; n=578)



*3 Estimated number of outlets: The number of outlets derived from the "number of outlets in Japan" and the percentage of "current ownership and contract type" replied by the operators

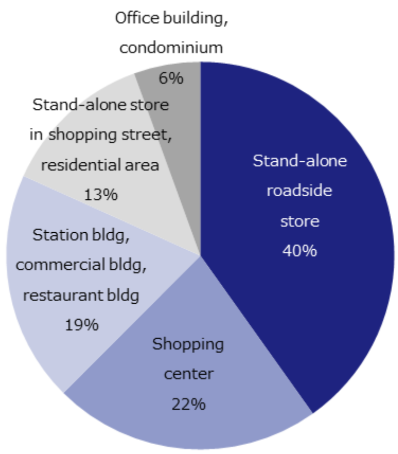
*4 Fixed-term land lease for business use: The landlord only lends the land, and the operator builds the outlet (to be owned by the operator) and pays the land rent to the landlord.

*5 Leaseback (construction fund): The operator deposits construction funds for the outlet to the landlord, who builds the outlet (owned by the landlord) and lends it to the operator (the operator pays the landlord monthly rent minus installment repayment amount of the construction fund).

2-3. Facility type and initial contract period

As for the facility type of existing outlets, the most common among the estimated number of outlets was "stand-alone roadside store" (40%), followed by "shopping center" (22%) (**Figure 11**).

Figure 11: Facility Type of Existing Outlets (Multiple Answers; n=574)

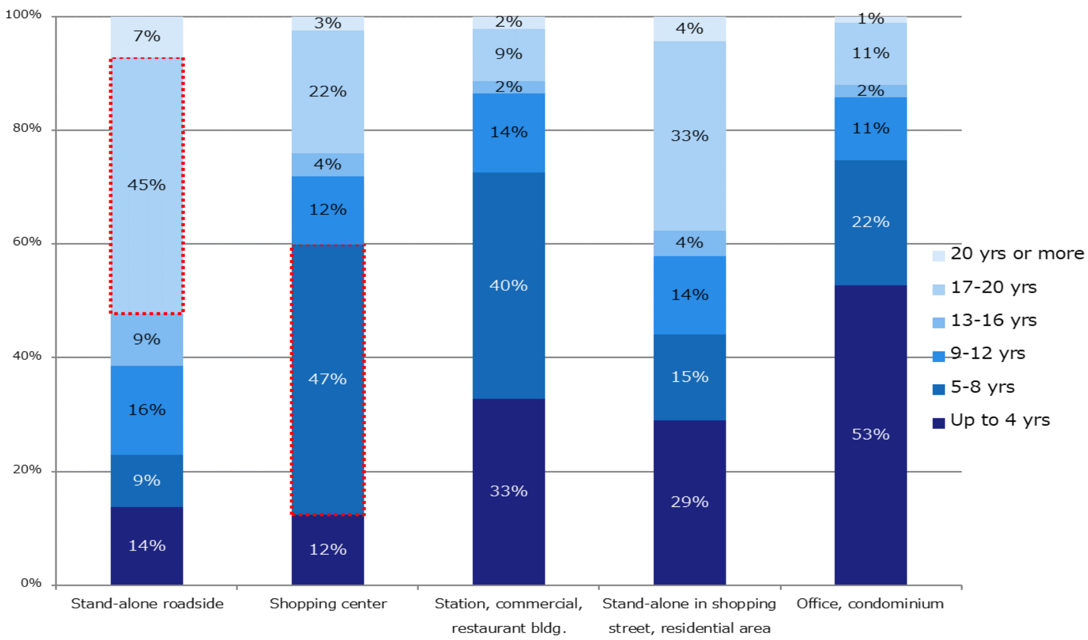


Of the above, the most common initial contract period for stand-alone roadside leased outlets was a long "17–20 years" (45%). For leased outlets in shopping centers, the majority was "5–8 years" (47%) (**Figure 12**). We believe the reason for the relative short contract period (mostly 5 or 6 years) for shopping centers is because they undergo renovations on a regular basis to maintain and improve the asset value of the facility.

(Reference) "How long will the tenants stay in the shopping center?" March 23, 2016

Comments obtained from interviews with operators included "a 20-year fixed-term tenant contract for roadside stores is too long," and "a 5-year fixed-term tenant contract for shopping centers is too short in terms of investment return," indicating a discrepancy between the business cycle of stores and the contract period.

Figure 12: Initial Contract Period of Leased Outlets (n=571)



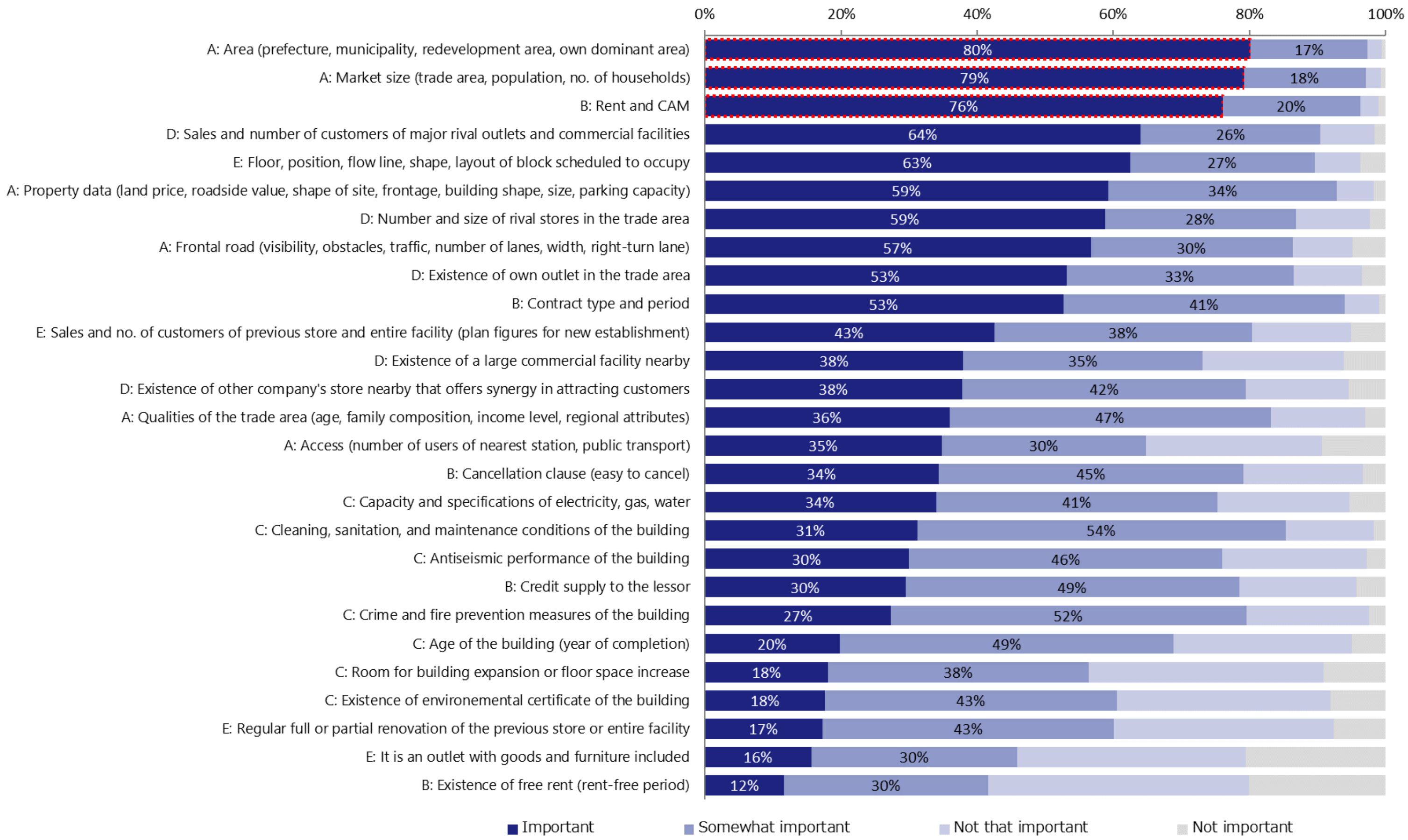
3. Store Openings

3-1. Priorities upon opening a new store

We classified the priorities upon considering opening a new store into: A) Location, market; B) Subscriber of the contract, terms of the contract (when leasing); C) Building, equipment; D) Rival stores; E) Other property conditions, and asked respondents their priorities for each of the 27 items. The top item that respondents placed priority was "A: Area" (80%), followed by "A: Market size" (79%) and "B: Rent and CAM fees" (76%) (**Figure 13**).

In terms of the above five classifications, priority on "A: Location, market" and "D: Rival stores" was high, while priority on "C: Building, equipment" was low in general. We believe operators, when opening a store as a tenant in a leased building, think that the owner of the facility should be responsible for the maintenance of the building and equipment. Furthermore, an operator said in the interview that almost any shortage in the building or equipment specifications (the repair of which is at the operator's expense) can be solved if money is spent.

Figure 13: Priorities upon Opening a New Store (n=576)

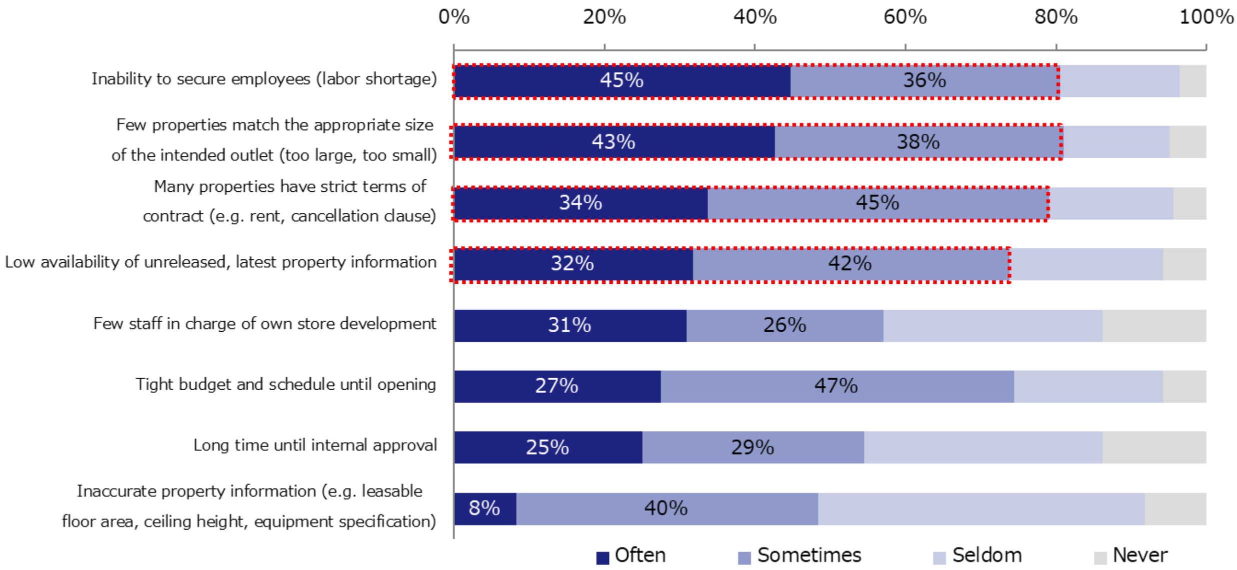


A: Location, market B: Subscriber of the contract, terms of the contract (when leasing) C: Building, equipment D: Rival outlets E: Other property conditions

3-2. Problems upon opening a new store

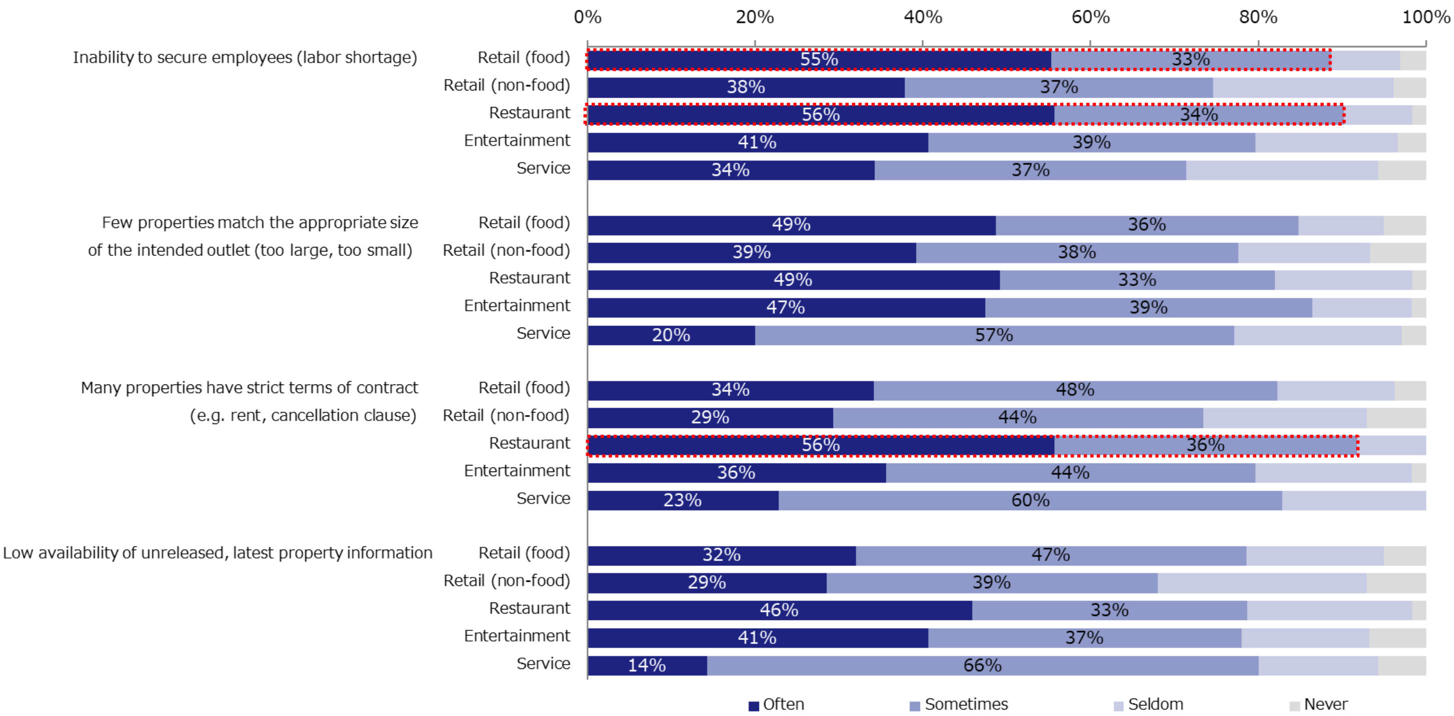
Regarding the frequency and degree of problems upon opening a new store, the percentage of "often" and "sometimes" was large in "labor shortage," "few properties of appropriate size," "strict terms of contract," and "low availability of unreleased property information," in this order (**Figure 14**).

Figure 14: Problems upon opening a new store (n=569)



When we look at the top replies of "often" and "sometimes" in **Figure 14** by industry/category, the percentage "labor shortage" is especially high in the retail (food) and restaurant sectors. "Strict terms of contract" is especially high among restaurant operators, with the percentage exceeding 90% (**Figure 15**).

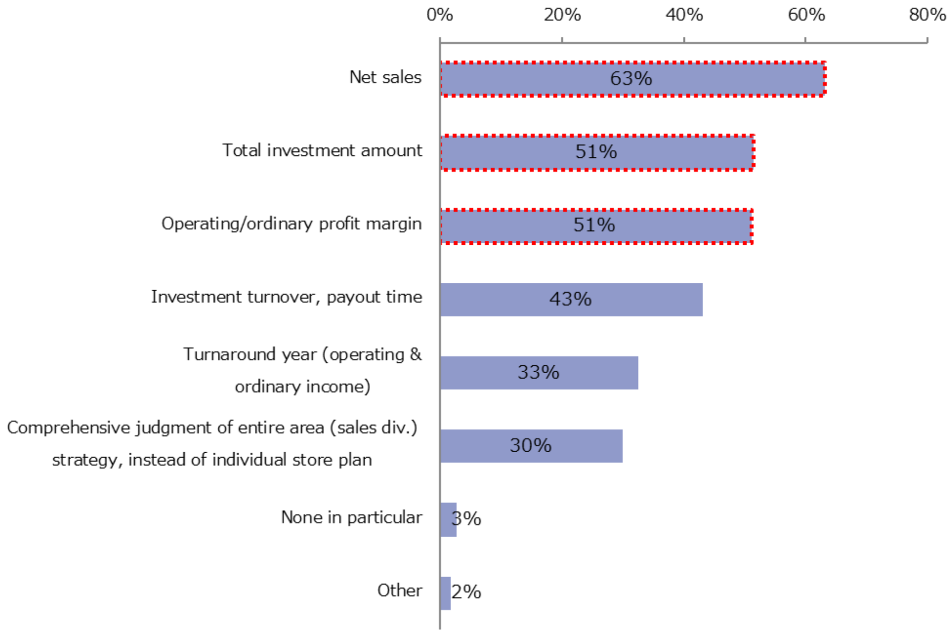
Figure 15: Problems upon opening a new store; by industry/category (n=569)



3-3. Priority benchmarks upon internal approval

The top priority benchmark upon obtaining internal approval for opening a new store was "net sales" (63%), while more than half also placed importance on "total investment amount" (51%) and "operating/ordinary profit margin" (51%) (**Figure 16**). Most operators decided store openings using more than one benchmarks.

Figure 16: Priority Benchmarks upon Internal Approval (Multiple Answers; n=576)

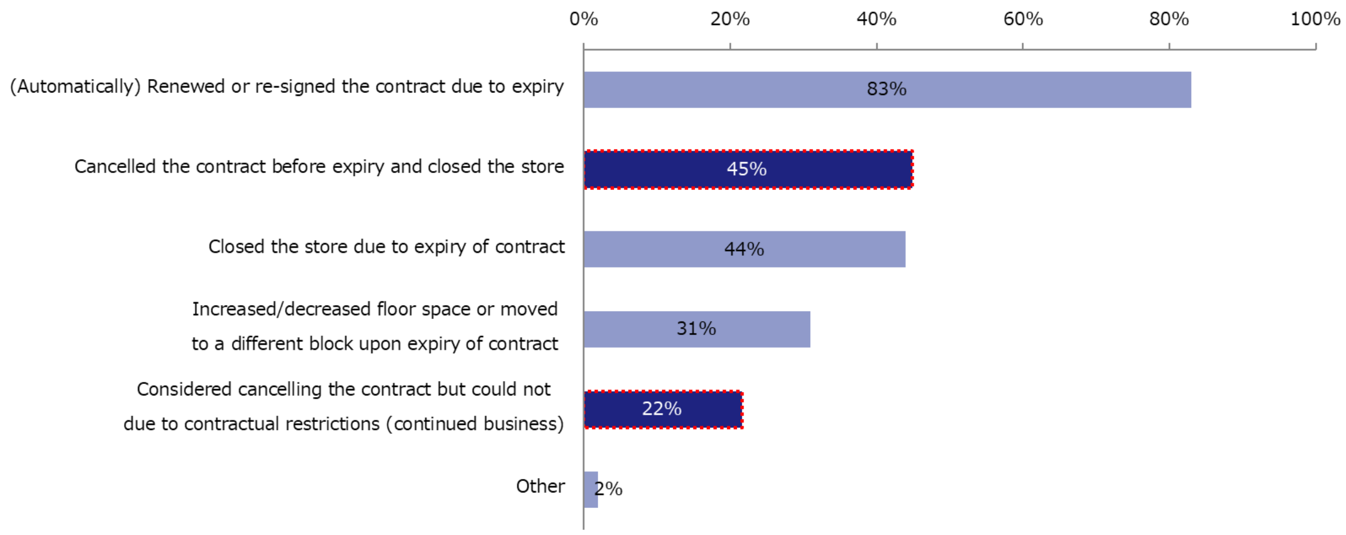


4. Store Closures

4-1. Cancellation of contract before expiry

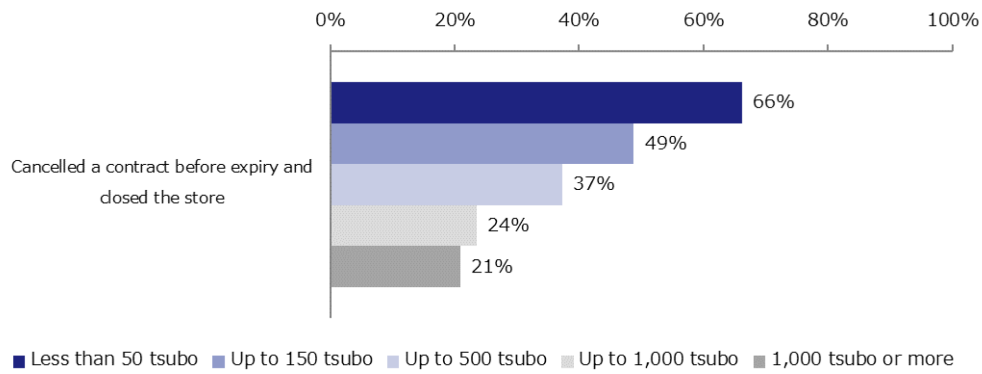
As for the situation of leased outlets in the last three years, 45% of operators replied that they had cancelled a contract before expiry and closed the store. 22% replied that they considered cancelling a contract before expiry but could not do so due to contractual restrictions (and continued business) (**Figure 17**).

Figure 17: Situation of Leased Outlets in the Last three Years (Multiple Answers; n=565)



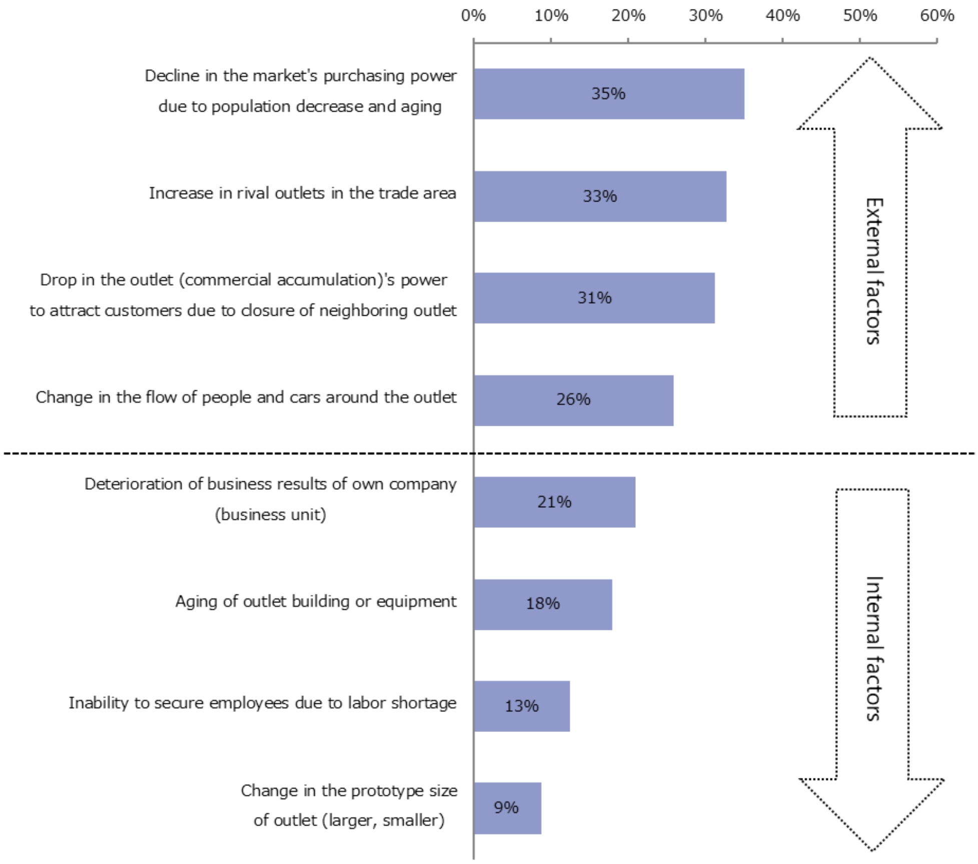
The smaller the operator's outlets were, the higher the percentage was of the operator cancelling a contract before expiry and closing the store. We believe this is probably because operators with smaller outlets operate many stores and have a higher building lease ratio (**Figure 18**).

Figure 18: Cancellation before Expiry by Size of Outlet (Multiple Answers; n=560)



The top reasons for cancelling a contract before expiry were external factors such as a "decline in the market's purchasing power," "increase in rival outlets," and a "drop in the outlet (commercial accumulation)'s power to attract customers due to closure of a neighboring outlet" (**Figure 19**).

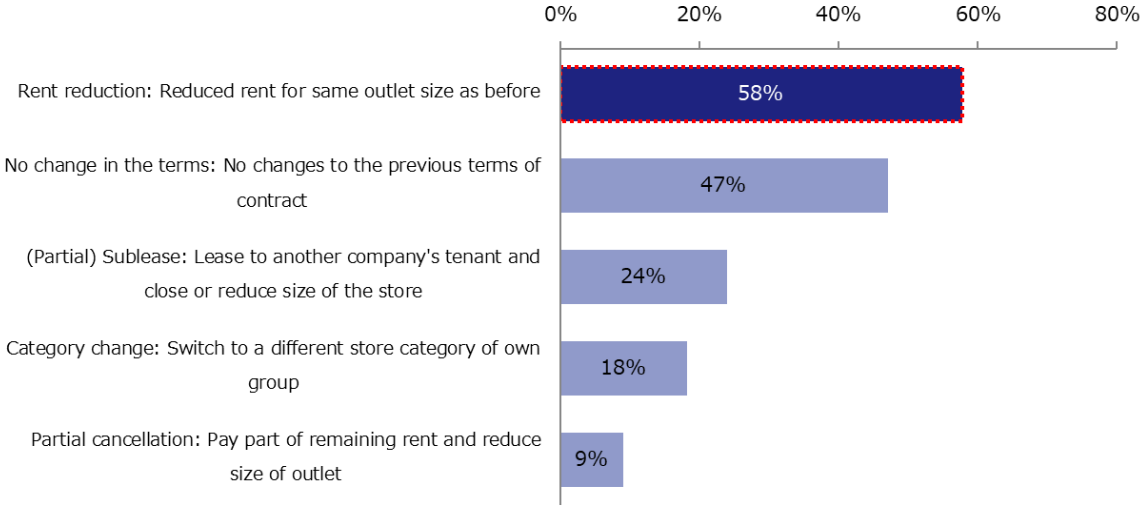
Figure 19: Reason for Cancellation before Expiry (Multiple Answers; n=253)



4-2. Change in the terms of the lease for outlets that continued business due to inability to cancel the contract

The most common change in the terms of the lease among operators who had a leased outlet they continued business in over the last three years since they could not cancel the contract (22%) in **Figure 17** was "rent reduction" (58%). "No change in the terms" (47%) followed (**Figure 20**).

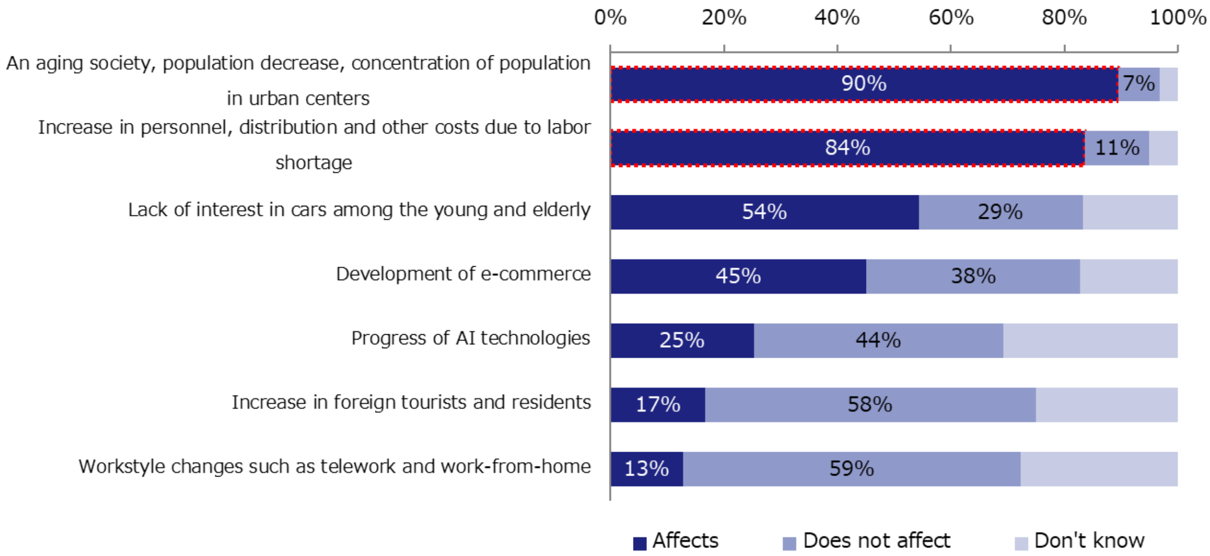
Figure 20: Change in the Terms for Outlets that Continued Business due to Inability to Cancel the Contract (Multiple Answers; n=122)



5. Factors that Affect Future Store Opening and Closing Strategies

In terms of social and economic factors that affect operators' future store opening and closing strategies, factors that stood out as having an effect were "an aging society, population decrease, concentration of population in urban centers" (90%) and "increase in personnel, distribution and other costs due to labor shortage" (84%) (**Figure 21**).

Figure 21: Factors that Affect Future Store Opening and Closing Strategies (n=576)



6. Comments Gained from the Interviews with Operators

<Contract type>

- If the property was good, we will open a store regardless of the type of contract.
- A leaseback (construction fund) will allow us to reduce running cost since the store owner bears the cost of repairs and maintenance of the building.
- The building specifications are part of our corporate identity. We don't want other companies to use them so we opt for fixed-term land lease for business use and demolish the building when we return the land.
- Shopping centers are mostly fixed-term tenant contracts, but stand-alone roadside outlets are still relatively ordinary tenant contracts.

<Contract period>

- The initial contract period for stand-alone roadside outlets is often 20 years, which I think is long. We try to negotiate for the right to cancel the contract before expiry even in fixed-term tenant contracts.
- The contract for shopping centers is usually a fixed-term tenant contract with an initial period of five or six years in the restaurant industry, which makes it difficult for some stores to secure investment return. We prefer a longer contract period.

<Priorities upon considering opening a new store>

・In property development, the most important above all is location and market.
・In principle, if we open a store in a shopping center, we will only do so in the region's number one shopping center because there is a limit to what you can do if the shopping center's overall sales were not large.
・Almost any shortage in the building or equipment specifications can be solved if money is spent (although up to a certain limit).
・Since our stores are designed with specifications shared by all of our stores, a skeleton specification is more preferable than a property with goods and furniture included.
・We do not care about free rent at all. If the property is attractive, we will go for it even if we had to increase our deposit or raise the terms of rent.

<Problems upon opening a new store>

・Due to labor shortage, the hourly wages for part-time workers have become quite expensive in some areas.
・Today there is a need to train personnel with foreign language skills, in addition to product knowledge and customer service etiquette.
・The competition for properties has intensified due to the expansion of the scope of the space for each industry and business category to operate compared to before.

<Cancellation of contract before expiry>

・We maintain a good relationship with the facility owner and landlord so that we can re-sign the contract (under a fixed-term tenant agreement).
・We will cancel the contract and relocate if we find a good property nearby.
・Even if the building or equipment has aged, we will try to continue the store as much as possible if there is possibility of a turnaround by renovating.
・If the area had strong a brand factor, we will not cancel the contract even if profit/loss was not so good.
・Since the developer bears the cost for C construction work, we will keep the contract until expiry.
・Even if the contract was based on cancellation before expiry, we will first request a rent reduction.

7. Summary

The questionnaire survey and interviews have revealed the actual situation of store openings and closures by commercial operators. The most important factors for outlets were location and the market. We believe the optimal store strategy for many operators is to capture the changes in the market environment and consumer behavior and carry out store openings and closures accordingly.

The questionnaire and interviews also indicated that there was a discrepancy between the business cycle of stores and the contract period from the perspective of the investment payout time (i.e. too short or too long). This means that the needs and interest of landlords and operators do not always match, and that how operators hedge their risks will be an important issue that affects the result of the opening or closure of stores.

Xymax REI and the laboratory of Professor Yukio Komatsu of the Department of Architecture at Waseda University conducted a questionnaire survey on the repair of commercial outlets last year. The questionnaire survey on the opening and closure of commercial outlets is the second of such surveys. Xymax REI will continue its research on commercial facilities and outlets to publish useful information.

Survey Overview

Period	May – August 2017
Targets	Of retail (food), retail (non-food), restaurant, entertainment, and service sector*1*2 operators that target personal consumption, 5,117 companies with net sales of 3 billion yen or more in the latest fiscal year*3 *1: Industries and categories that currently operate outlets in shopping centers, commercial buildings, or roadside, which are Japan's main commercial facilities, based on Japan's industry classification by the Ministry of Internal Affairs and Communications *2: Target companies in the service industry are beauty & barber, travel, education, insurance, and real estate companies that operate outlets in a commercial facility. *3: Targets were extracted based on data by Tokyo Shoko Research
No. of valid responses	Questionnaire: 586 companies (response rate: 11.5%) Interview: 9 companies
Geographical coverage	Nationwide
Method	Questionnaire survey by post or online, and interview
Survey details	I. Business and outlet II. Contract type III. Store openings & closures

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