Xymax Real Estate Institute
RESEARCH REPORT

Fact-Finding Study on Real Estate Strategies of Commercial Outlets 2018

Findings from questionnaires and interviews with commercial operators

November 29, 2018

Commercial facilities are a major type of real estate, along with offices, with certain characteristics in the real estate strategies of stores (i.e. how to utilize store real estate) carried out by commercial operators (hereinafter referred to as "Operators"). Real estate strategies are wide-ranging, from relocating and renovating to closing own store and subleasing to an external tenant, and span up to several decades from the opening of the store to closure. They are also implemented frequently. However, there have hardly been any quantitative and qualitative analyses on these matters.

To unveil their reality, Xymax Real Estate Institute (hereinafter referred to as "Xymax REI") conducted the "Fact-Finding Study on Real Estate Strategies of Commercial Outlets 2018" in partnership with the laboratory of Professor Yukio Komatsu of the Department of Architecture at Waseda University,[*1] targeting commercial operators that operate or control multiple outlets.[*2] This report has summarized the details, changes, and issues of Operators' real estate strategies. The results of a survey on the management of store information, which forms the basis of real estate strategies, is summarized in the "Fact-Finding Study on Information Management of Commercial Outlets 2018,"[*3] published by Xymax REI on the same day.

This report is a sequel to the "Fact-Finding Study on the Opening & Closing of Commercial Outlets 2017,"[*4] published last year. We hope this study will assist in the efficient formulation of stores' real estate strategies.

*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 aimed at personal consumption 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).
*3 ,*4 https://www.xymax.co.jp/english/news_research/?type=research

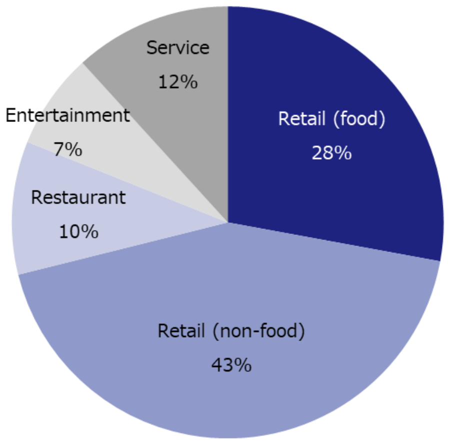
Key Findings

- **In a comparison of today's store opening policies with those of three years ago, the percentage of Operators with a policy of aggressively opening stores to increase the number of outlets has decreased, indicating that Operators have become more cautious about store openings.**
- **The largest factor for the change in store opening policies was shortage of labor. Interviews with Operators suggest that not only the shortage but also a drop in the retention rate was a big issue.**
- **The most common response to unprofitable stores was closing the store, with more Operators placing importance in this policy than three years ago.**
- **For store renovations, more Operators intend to prioritize stores with strong sales than unprofitable stores.**
- **The top three real estate strategies implemented by Operators over the last three years were "new store opening," "renovation of stores with strong sales," and "closing of unprofitable stores."**

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 those of all Operators to whom we sent the questionnaire.

Figure 1: Industry/Category of Core Business (Single Answer; n=391)



In terms of the number of stores in Japan, many Operators in the restaurant industry operated 50 stores or more **(Figure 2)**. Asked where stores were located in terms of the eight areas of Hokkaido, Tohoku, Kanto, Tokai, Hokuriku/Koshinetsu, Kansai, Chugoku/Shikoku, and Kyushu/Okinawa, more than 80% of Operators in the retail (food) and entertainment industries were community-based, with stores located in one area **(Figure 3)**.

Figure 2: No. of Stores in Japan (Single Answer; n=389)

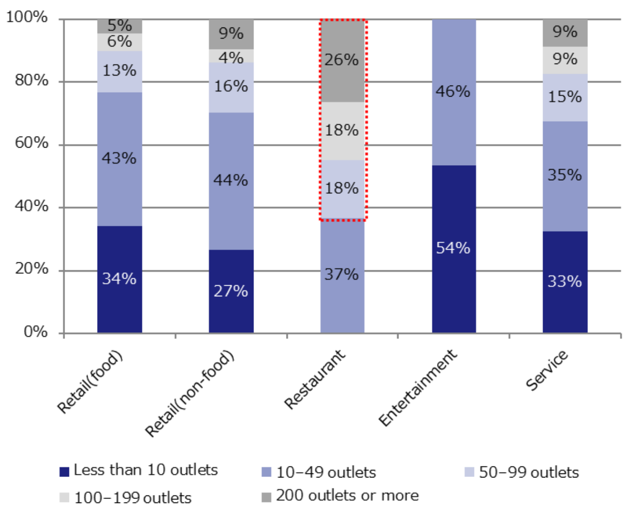
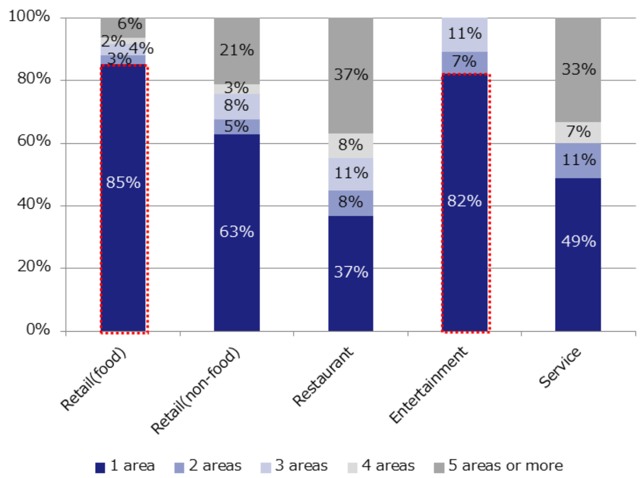


Figure 3: Area of Stores (Multiple Answers; n=388)



The size of a standard outlet was small among restaurant operators, with more than 90% having a size of 150 tsubo (1 tsubo=3.3 sqm) or less **(Figure 4)**. The most common format of existing stores was a roadside stand-alone store in all industries and categories except for the service industry **(Figure 5)**.

Figure 4: Size of a Standard Store (Single Answer; n=384)

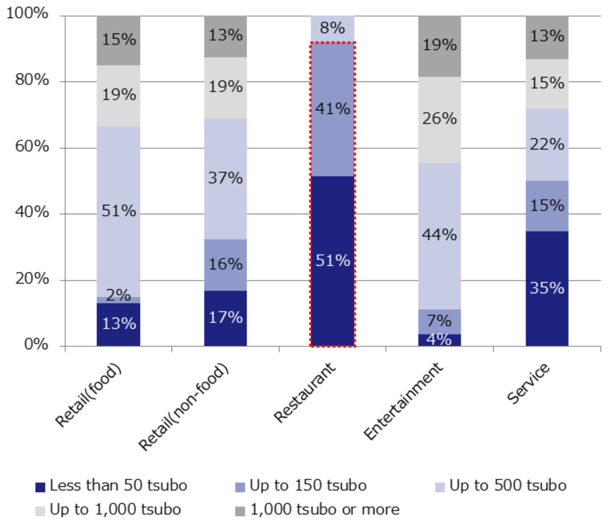
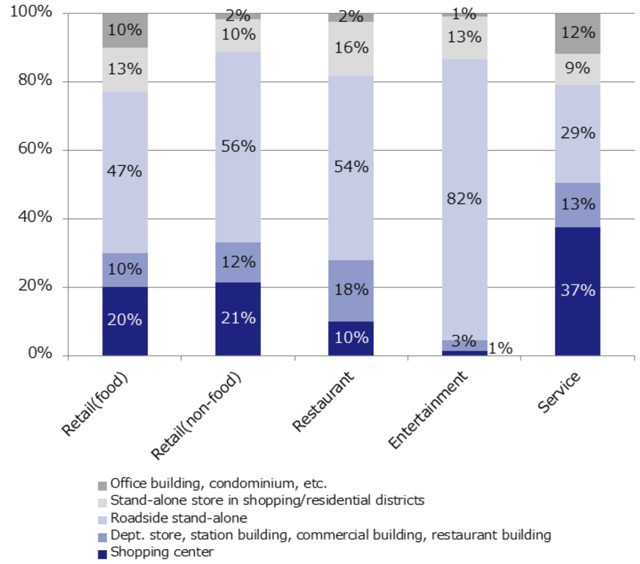


Figure 5: Format of the Facility (Multiple Answers; n=382)

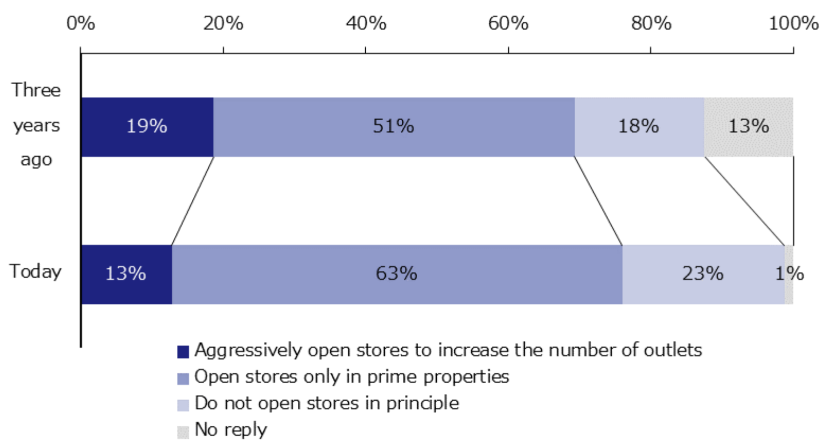


2. Real Estate Strategy of Stores (How to Utilize Store Real Estate)

2-1. Policy of new store openings <Three years ago→Today>

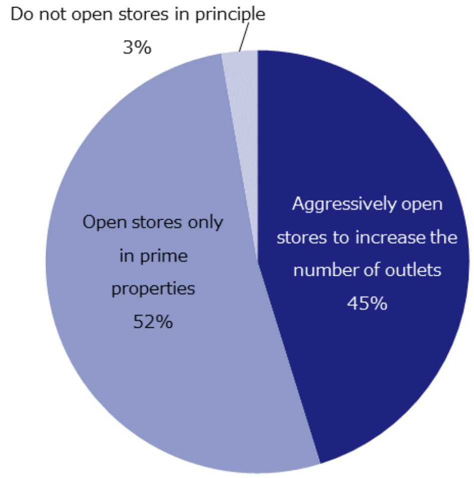
When we asked about the policy of new store openings of three years ago and today, Operators with a policy of aggressively opening stores to increase the number of outlets decreased from three years ago, while Operators with a policy of opening stores only in prime properties and Operators not opening stores in principle increased, indicating that many Operators are cautious about opening new stores **(Figure 6)**.

Figure 6: Policy of New Store Openings (Single Answer; n=391)



Of Operators that had a policy of aggressively opening stores to increase the number of outlets three years ago, only 45% maintained the same policy today, while a majority (52%) of Operators changed their policy to opening stores only in prime properties and 3% changed their policy to not opening stores in principle **(Figure 7)**.

Figure 7: Current Policy of Operators that Aggressively Opened Stores Three Years Ago (Single Answer; n=73)



Interviews with Operators revealed that the most common factor for Operators being cautious about new store openings was shortage of labor, while other common factors were changes in the external environment surrounding Operators, such as the surge in construction costs, a rise in rent, and difficulty in securing properties. With regard to external factors such as shortage of labor, even Operators with no change in store opening policy said that the impact was large, which suggests that such factors are concerns for all Operators.

On the other hand, internal factors varied between Operators. One said they had stopped opening new stores due to business structure reforms following an M&A or a change in the parent company and was closing unprofitable stores, while another said that they were focusing on renovations due to the aging of the large number of stores they opened more than a decade ago.

Several Operators in the apparel business that operated stores mainly in shopping centers said they have already opened stores in priority areas of the store opening strategy.

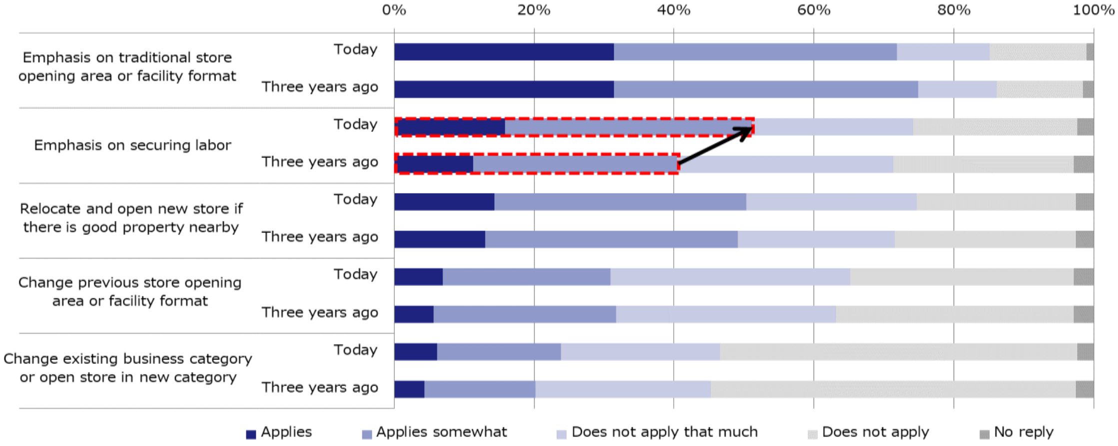
2-2. Policy in real estate strategies <Three years ago→Today>

We classified real estate strategies of stores into four groups of “A: new store openings,” “B: unprofitable stores,” “C: stores with strong sales,” and “D: change or implementation of scheme” and asked Operators’ policies of three years ago and today for a total of 18 strategic items.

<A: New store openings>

The policy with the largest percentage of “applies” and “applies somewhat” replies both three years ago and today was “open store with emphasis on traditional store opening area or facility format.” The percentage was largely unchanged. The policy that saw the largest change was “open store with emphasis on securing labor,” rising from approximately 40% three years ago to more than 50% today. This is the largest growth rate in all 18 items in A to D above **(Figure 8)**.

Figure 8: Policy in Real Estate Strategies <A: New Store Opening> (n=391)

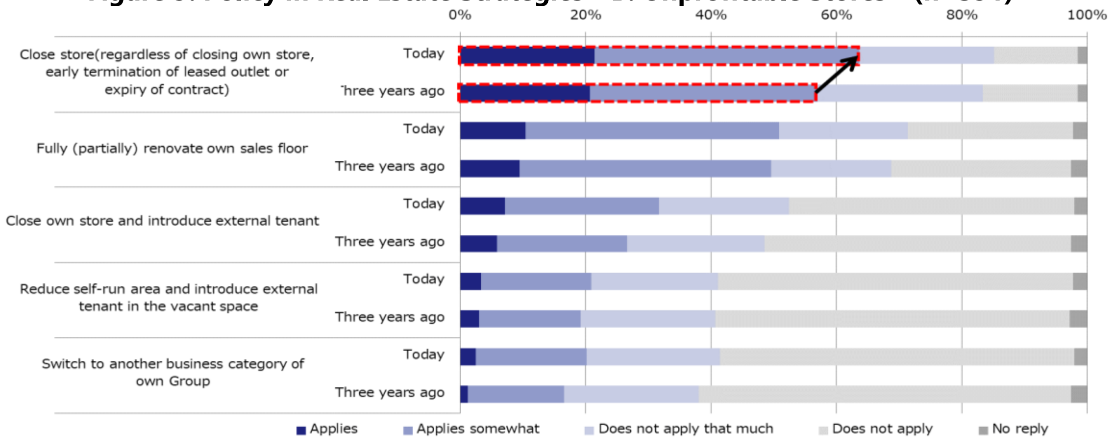


In the interviews, many Operators stated that securing labor such as part-time employees was more difficult in urban areas than in rural areas, resulting in having to increase hourly wages. A drop in the retention of personnel secured has also become a big issue. While Operators are making efforts in workstyle reforms, improvements in ES (employee satisfaction), and increasing foreign workers especially in the restaurant business, we believe that many Operators have not yet come up with a fundamental solution to securing labor.

<B: Unprofitable stores>

Operators placed the most importance in “close store (regardless of closing own store, early termination of leased outlet or expiry of contract)” as a policy, rising significantly from three years ago **(Figure 9)**.

Figure 9: Policy in Real Estate Strategies <B: Unprofitable Stores> (n=391)



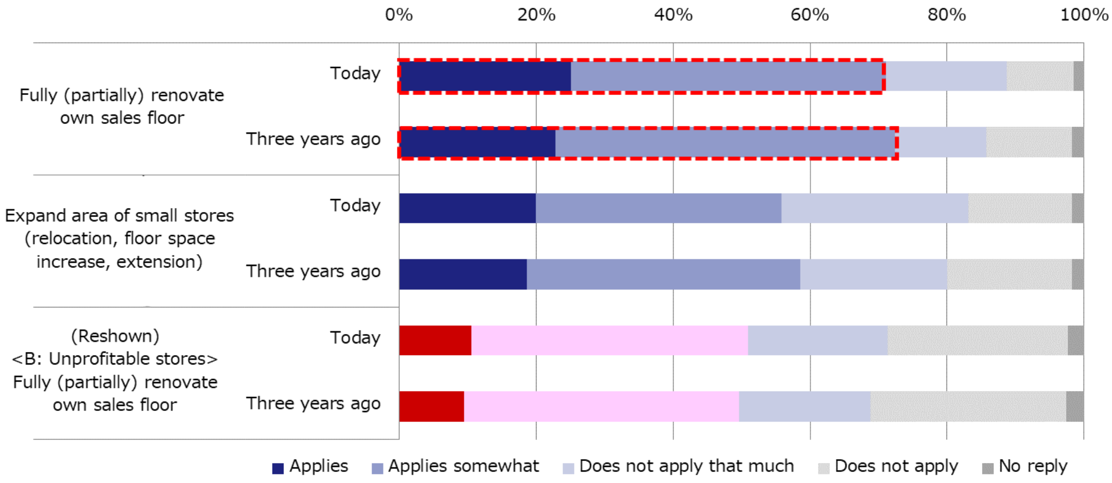
The interviews revealed that almost all Operators negotiated with the lessor upon opening a new store under a fixed-term lease contract to add an early termination clause in the contract. Although the specific conditions negotiated differ between Operators, some contracts were close to an ordinary lease contract, with a six-month notice and no penalty. On the other hand, some properties did not allow early termination, indicating that the details of the early termination clause vary depending on the power balance between lessor and lessee, the Operator.

One Operator said there was no closing of stores due to the expiry of contract since they immediately pulled out if a store fell into the red and a turnaround could not be expected. The greater availability of early termination compared to before is likely to have influenced Operators' aggressive store closing strategies.

<C: Stores with strong sales>

While "fully (partially) renovate own sales floor" did not see a significant change from three years ago, more than 70% of Operators placed importance on the strategy both three years ago and today. The strategy ranked second most applicable among the 18 items in A to D **(Figure 10)**. It was also around 20 points more applicable compared to the same strategy for B: unprofitable stores (displayed in **Figure 10** for reference), which indicates that many Operators prioritize stores with strong sales.

Figure 10: Policy in Real Estate Strategies <C: Stores with Strong Sales> (n=391)



The interviews revealed that the common reasons for prioritizing stores with strong sales for renovation were that the cost effectiveness of investment was larger than in unprofitable stores and that unprofitable stores became candidates for closings, hence their lower priority. Only one Operator had a policy of aggressively renovating both stores with strong sales and unprofitable stores.

As we mentioned in "2-1. Policy of new store openings <Three years ago→Today>," we believe that the higher hurdles for new store openings due to changes in the external environment surrounding Operators are one of the reasons for Operators to focus on renovating stores with strong sales as a way to revitalizing existing stores.

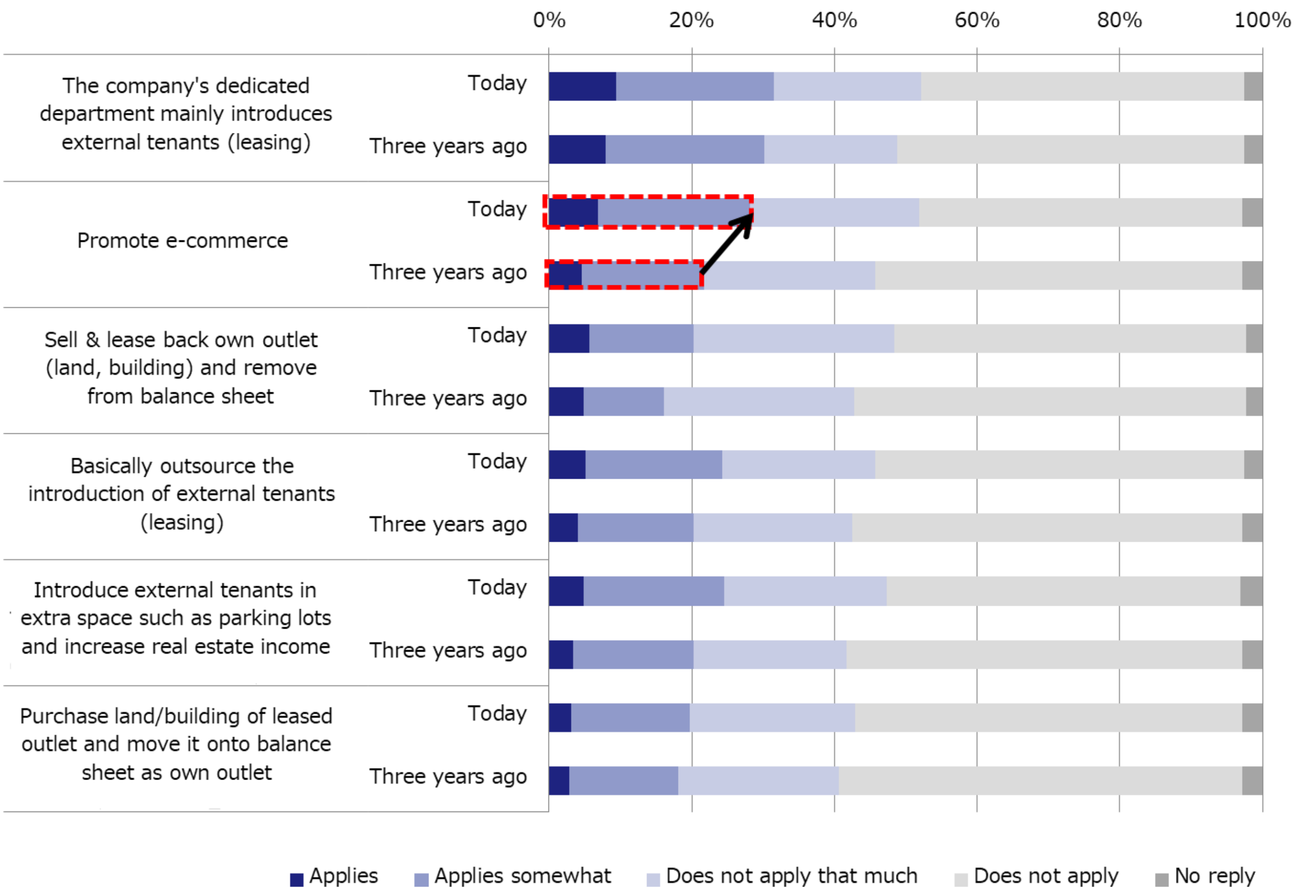
Operators that have stores in shopping centers, in particular, seem to be focusing on stores with strong sales for relocations and renovations at the request of the developer upon upgrade of the facility or re-signing of the fixed-term lease contract.

We believe that these trends will continue in the short term.

<D: Change or implementation of scheme>

Compared to A–C, focus on these strategies was generally low **(Figure 11)**. Although "promote e-commerce" saw a relatively large increase from three years ago, less than 30% of Operators currently placed emphasis on the strategy. Looking at the results by industry/category for reference, the percentage was only around 35% even in the retail (food) industry, which placed the highest importance on the strategy.

Figure 11: Policy in Real Estate Strategies <D: Change or Implementation of Scheme> (n=391)



When we asked Operators in the interviews the situation of "off-balance-sheet: selling & leasing back own outlet (land, building)" and "on-balance-sheet: purchasing land or building of leased outlet and owning the outlet," there were hardly any Operators that actively pursued these strategies, which was the same result as in the questionnaire. Off-balance-sheet measures seem to be carried out in a limited way, such as making an FC outlet a directly-operated store and purchasing a leased outlet at the request of the lessor with whom the Operator had a long relationship.

In the "Fact-Finding Study on the Opening & Closing of Commercial Outlets 2017" conducted last year, around 90% of Operators' outlets were leased, suggesting that interest in changing the scheme was not high in the first place.

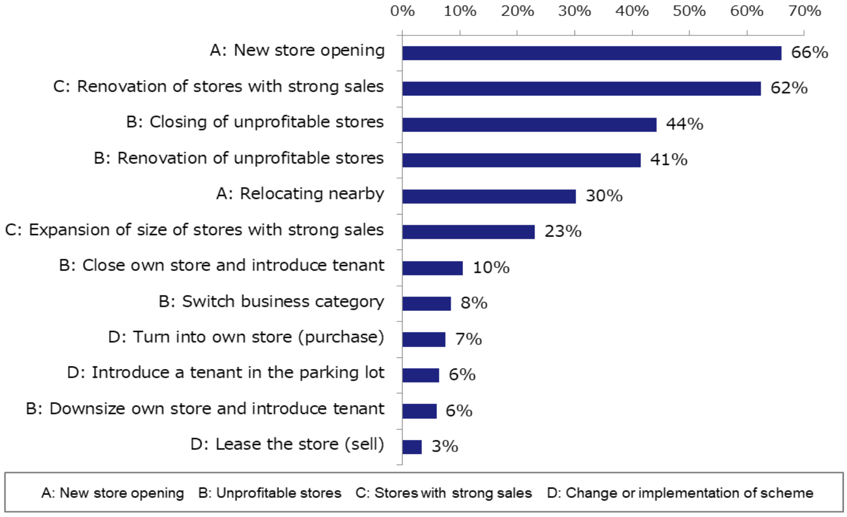
2-3. Real Estate Strategies Implemented by Operators over the Last Three Years

In 2-2 we looked into Operators' policies in real estate strategies of stores three years ago and today. Here we asked about the actual implementation of the strategies of A–D below over the last three years **(Figure 12)**.

The top three strategies implemented by Operators were "A: New store opening" (66%), "C: Renovation of stores with strong sales" (62%), and "B: Closing of unprofitable stores" (44%), with the order being store opening, renovation, and closing. As mentioned in "2-1. Policy of new store openings <Three years ago→Today>," although more Operators are now cautious about opening stores, new store openings are currently the major real estate strategy of stores.

Worth noting is "B: Closing of unprofitable stores," which was implemented by nearly half of the Operators. This suggests that store openings and closings are not separate matters for Operators but two sides of the same coin and the core of real estate strategies, carried out on a continuous basis.

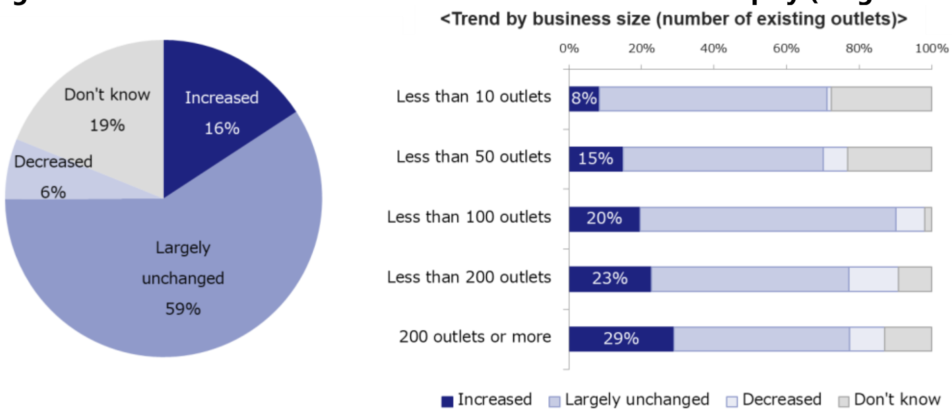
Figure 12: Implementation of Real Estate Strategies (Multiple Answers; n=391)



Of the closings of unprofitable stores, we asked Operators the change in the number of stores that were closed before expiry of the contract between the last three years and the three years prior. "Largely unchanged" was the top reply (59%), while there were more "increased" (16%) than "decreased" (6%) **(Figure 13, left)**.

The trend by the size of Operator (based on the number of existing outlets) indicated that the more stores the Operator had, the higher the percentage of "increased" replies was **(Figure 13, right)**.

Figure 13: Change in the No. of Stores that were Closed before Contract Expiry (Single Answer; n=323)

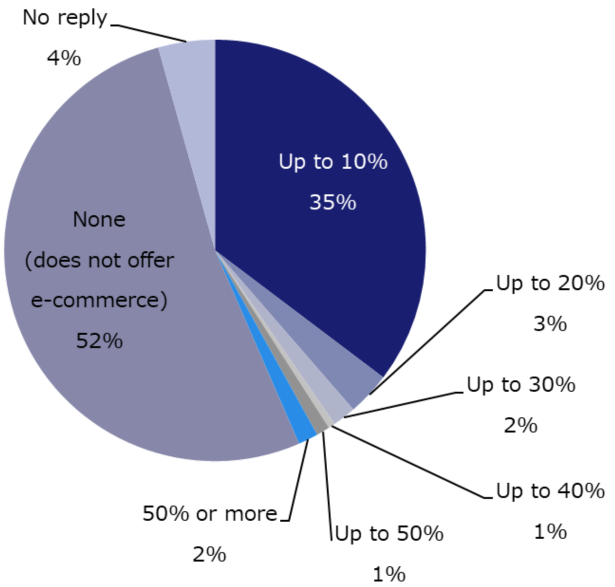


When we asked the reason for the increase in the number of stores that were closed before expiry of contract over the last three years, several Operators said that there was a mass closing of unprofitable stores due to a fundamental business structure reform following a change in the parent company due to M&A, etc.

2-4. E-Commerce

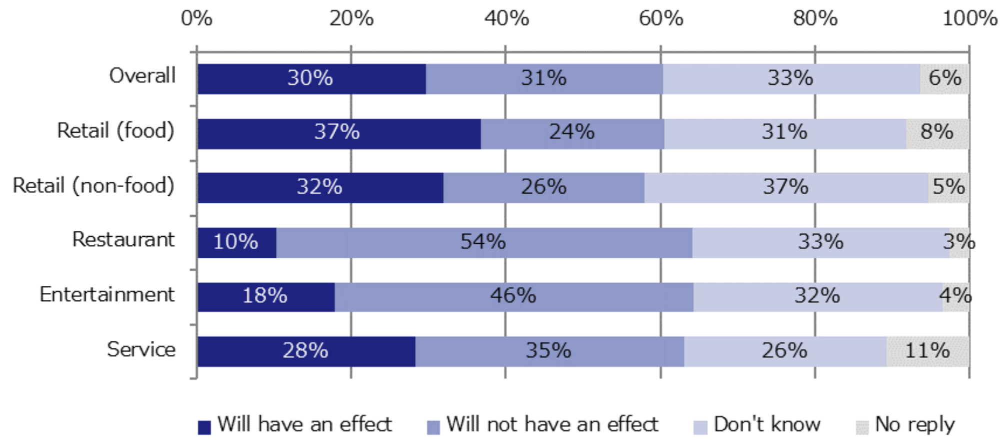
With regard to the current percentage of e-commerce sales, "None (does not offer e-commerce)" accounted for 52%, while the largest percentage of e-commerce sales (35%) was "less than 10%" among Operators that offered e-commerce. The sum of Operators with more than 10% of e-commerce sales was only 9% **(Figure 14)**.

Figure 14: Percentage of E-Commerce Sales (Single Answer; n=391)



As for whether the expansion of the e-commerce market in society would have an effect on the real estate strategies of stores, "will have an effect," "will not have an effect," and "don't know" each accounted for around 30%, with the retail (food) industry showing the largest percentage of "will have an effect" replies (37%) **(Figure 15)**.

Figure 15: Impact of the Expansion of the E-Commerce Market in Society (Single Answer; n=391)



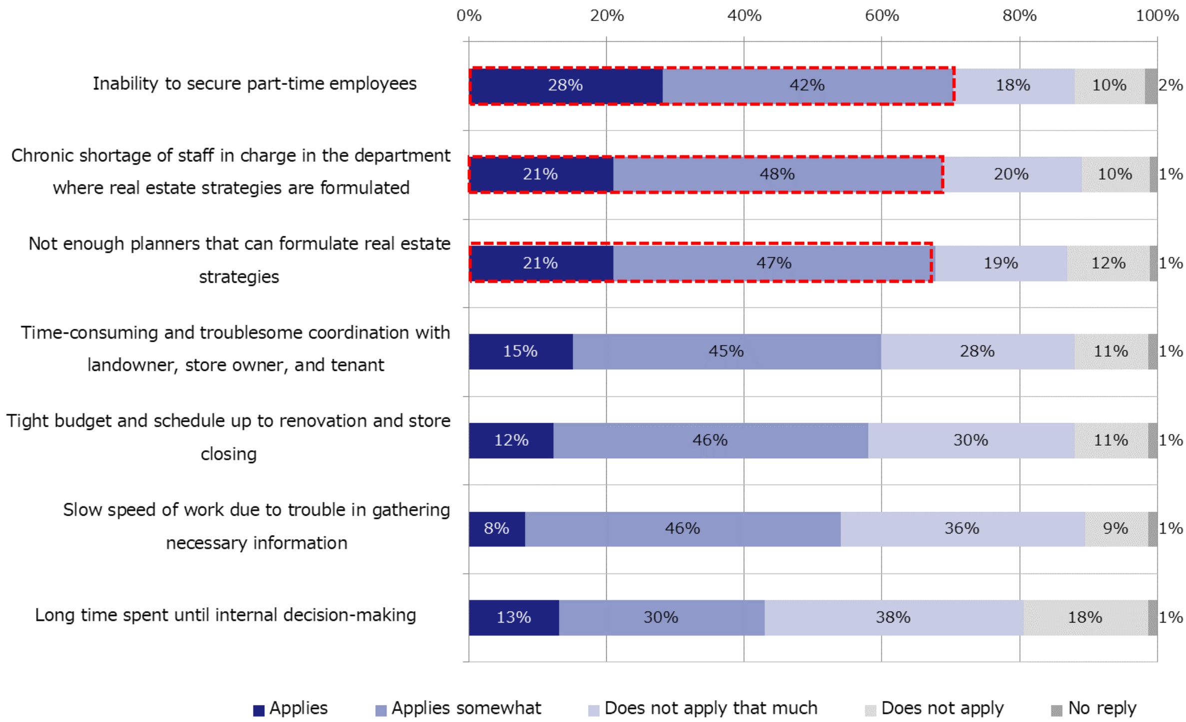
When we asked Operators in the interviews about their future targets in e-commerce sales, only a few Operators had set a clear target.

One specific impact of e-commerce mentioned by a restaurant operator was the decrease in population and expansion of the e-commerce market likely leading to a drop in visitors to shopping centers, resulting in difficult sales not only in merchandise but also in food and beverages (non-merchandise), which could not be solved by individual stores' efforts alone.

3. Operational and Organizational Issues in Formulating Real Estate Strategies

When we asked Operators about the operational and organizational issues in formulating real estate strategies of stores, the top three issues with the most "applies" and "applies somewhat" replies were "inability to secure part-time employees" (70%), "chronic shortage of staff in charge in the department where real estate strategies are formulated" (69%), and "not enough planners that can formulate real estate strategies" (68%) **(Figure 16)**.

Figure 16: Issues in Formulating Real Estate Strategies (Single Answer; n=391)



In the interviews, several Operators said that they had experienced giving up on opening a new store since they could not secure part-time staff. Another Operator who operated stores basically as a franchise said that they had difficulty even finding an owner, let alone part-time employees.

When we asked Operators who replied that they faced a chronic shortage of staff in charge in the department where real estate strategies were formulated about the reality of the situation, one Operator said that compared to competitors they had an extremely small number of development staff relative to the number of stores, and that the development department bore a huge work load by not only being in charge of new store openings but also of renovation plans and store closing strategies. However, there was no extra staff in other departments either so there was nothing they could do.

Furthermore, regarding the issue of there being not enough planners who can formulate real estate strategies, an Operator said that becoming a full-fledged planner requires an understanding of the work of the site (store) as well as the work of related departments and gaining experience through practical work as a planner, which takes time, and that although there hardly used to be any position changes of planners, these days competent planners were increasingly being transferred to corporate planning or area management posts.

4. Comments Obtained from Interviews with Operators

<Policy of new store openings>

- Store opening plans are based on sales forecasts, which an increasing number of properties fail to achieve. Also due to the difficulty in securing labor and the surge in rent and construction costs, we intend to narrow down properties in the future. (Retail (food)
- In order to maintain the scarcity value of our brand, we do not intend to increase the number of stores any more in Japan. (Retail (non-food))
- We place priority on securing a foothold in existing outlets. Opening new outlets are not easy in terms of hiring and training either. (Restaurant)
- Since we receive many requests from developers to open a store, we do not look for properties by ourselves. (Retail (non-food))
- We intend to aggressively open outlets in collaboration or jointly with other industries, and operate more outlets than we have ever had. (Restaurant)

<Securing labor>

- Regarding hiring and retaining part-time staff, we make sure that a worker-friendly environment, atmosphere, welfare & benefits, and utilization of paid leave lead to management assessment of store managers. (Retail (food))
- We reduced the number of stores to concentrate our best staff in one location. (Retail (non-food))
- We can hire if we raised hourly wages, but that is merely a makeshift solution. (Retail (non-food))
- The retention rate is low. There are many places to work in busy shopping districts, and workers will quickly move to another place if the conditions were better. (Entertainment)
- Currently foreign workers account for around 10% of total staff. (Restaurant)
- Our turnover rate is low since all of our employees are basically regular employees. (Retail (non-food))

<Store closings (early termination)>

- Since we receive a lot of inquiries we always negotiate for early termination ability. (Retail (non-food))
- We basically accept the conditions of certain developers' properties since we asked to open our store there. However, we include the term "upon discussion" to reduce cancellation fees. (Retail (non-food))
- The problem with fixed-term lease contracts is that subleasing is not allowed. It is not a problem in the U.S. and companies rent up when the rent is low and sublease when the rent rises. Major Japanese developers prohibit subleasing and do not include an early termination clause. (Service)

<Renovations>

- We prioritize stores with strong sales. Sales will grow by more than 10%. We do not actively renovate unprofitable stores even if we are requested to do so when re-signing the contract. In the future there will be more renovations to address the CFC regulations in 2020. (Retail (food))
- Renovation priorities are a sales-related matter. Our priorities in renovation are stores that are likely to have an investment effect and renovations to compete with rival stores. (Retail (food))
- We will consider re-investing if depreciation on the P/L is close to zero upon expiry of the fixed-term leasehold. (Retail (non-food))
- Sales hardly rise even after renovation if the product lineup does not change. Renovations are mainly carried out in aging stores. (Retail (non-food))

- We are currently experiencing many urgent repairs due to the mass openings about a decade ago and do not have the funds for renovations. (Restaurant)

<E-commerce>

- We used to do e-commerce before. Shipping costs were an issue. Now that shipping companies are requesting a rise in prices, retail e-commerce must be difficult. (Retail (food))
- We do not distinguish between physical and online stores. We are considering how to increase individuals' shopping opportunities by utilizing apps, etc., placing emphasis on customers instead of stores. (Retail (non-food))
- Insufficiencies in the store building, interior environment or personnel used to be tolerated but not any more now that e-commerce has grown to this level. Physical stores must do better. (Retail (non-food))
- We intend to continue strengthening e-commerce, but there will be no drastic changes to physical stores. We hope to link the two store types by mutually attracting customers. (Retail (food))

5. Summary

The questionnaires and interviews have revealed the reality of real estate strategies of commercial outlets. Although new openings are still the most major real estate strategy, more Operators are cautious about opening new outlets compared to three years ago on the back of changes in the external environment such as the shortage of labor. Furthermore, since aggressive closing of unprofitable stores is also becoming a major strategy, Operators are devising ways to facilitate this strategy such as including an early termination clause in the contract. We believe that changes in consumers' purchase behavior due to the expansion of the e-commerce market will also accelerate further.

There is no one correct solution that applies to all companies in terms of real estate strategies of stores. Operators must improve the precision of strategies for each outlet while paying careful attention to future changes in the external environment surrounding themselves. We believe that the current focus in real estate strategies of many Operators is to increase profits (improve profitability) than to expand the business. In the medium- to long-term, it is likely that consolidation will be more active in outlets that fail to fulfill the role of a profit center, or more specifically, outlets that cannot secure the necessary personnel for sales due to shortage of labor or outlets that cannot achieve the necessary sales due to the impact of e-commerce.

Xymax REI intends to continue its research on commercial facilities and outlets to publish useful information.

Survey Overview

Period	June – September 2018
Target	Of retailers (food and non-food), restaurant operators, entertainment providers, and service providers*1*2 aimed at personal consumption, 5,117 business operators with net sales of 3 billion yen or more in the latest survey year*3 *1: Industries and categories that currently operate in shopping centers, commercial buildings, or roadside outlets, which are currently Japan's main commercial facilities, based on Japan's industry classification by the Ministry of Internal Affairs and Communications *2: Target companies of 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: 391 companies (response rate: 7.6%); interview: 18 companies
Geographical coverage	Nationwide
Method	Questionnaire survey by post or online, and interview
Survey contents	I. Business and outlet II. Real estate strategies of stores III. Management of store information: Refer to https://www.xymax.co.jp/english/news_research/?type=research

Contact for inquiries concerning this report

Xymax Real Estate Institute

https://soken.xymax.co.jp

PHONE: **+81 3 3596 1477** | FAX: **+81 3 3596 1478** | E-MAIL: **info-rei@xymax.co.jp**