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# JOINT VENTURE

## A participatory business model between builders and retailers would do much to fuel retail mall growth in India

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India is in the midst of massive growth in the real estate industry. Every real estate segment - commercial, residential and industrial - is experiencing phenomenal growth and this is happening in all metros, their suburbs and in second-tier cities. While there is a constant debate about the sustainability of this growth and a softening market trend, one segment of the Indian real estate industry that has more questions than answers is the Retail Mall segment.

Retail Malls are being built across the country and many of them compete with their counterparts in the western world for their grandeur, facility and infrastructure. But what is of concern to many builders and retailers is the low occupancy level and low business growth seen in the existing malls. This concern can become a serious problem considering that India will have 500 malls operational in the next two to three years. The main reason quoted for this low occupancy is the high rental rate in these malls. This, compounded by low sales, is keeping many retailers away.

As the organised retail sector in India has tapped only 3% of its potential, one has to wonder what factors are inhibiting growth in this segment. One can understand this segment's problems better by analysing them closely.

Builders are pricing the rents higher to recover their investment cost faster. Considering the traffic nightmare and travel times, consumers prefer to go to a few places and quench their shopping appetite instead of hopping from one mall to the other, leading to lower foot traffic to these malls. This leads to lower than expected sales, discouraging retailers especially the mid-size retailers to open multiple stores.

As rents are increasing constantly, neither builders nor retailers are committing to long-term leases. Big retailers end up buying spaces and builders also opt to sell rather than rent. This leaves out the mid-size retailers with fewer space choices and hence the low occupancy.

Looking from outside we may see this as a problem between the builders and the retailers, each driven by their own business objectives: Builders looking for high rent paying or buying tenants and retailers waiting for predictability in sales and cost in these malls. By looking a little deeper one can quickly see that the fundamental driver of this segment's growth is not the availability of mall space or the willingness of retailers to open more stores, but the foot traffic to these places. Considering the infrastructure constraints we are facing in India that restricts foot traffic growth, builders and retailers have to change their business model if they want to see significant growth and profit in the retail mall segment.

An insight into the retail mall business model being followed in the western world can give a few good ideas. Adapting them to Indian environment and practicing them can fuel this segment's longterm growth. Here are a few practices that are widely followed (with local adaptations) both in US and Europe that are worth considering.

Percentage Rent is a feature that is prevalent with both big retailers and mid-size retailers. Here the tenant pays a minimal rent each month and pays a percentage of their revenue as rent to the landlord. This enables the retailer to reduce their rent liability and concentrate on promoting sales. This also attracts many retailers and hence mall occupancy level increases. Foot traffic increases, increasing sales to retailers and rent revenue increases to landlords.

Landlords encourage big retailers to build their own internal permanent infrastructure. This not only reduces the cash flow for a builder but they also get the right interior design expertise. This gives retailers the advantage of building a store to their requirement and helps them avoid re-construction and refitting cost. Towards this cost, landlords provide a construction allowance to a retailer, which is amortised over many months of rent payment.

Mall owners understand the mid-size retailers' dependence on the foot traffic big retailers bring to their mall. So, big retailers are given a lesser proportion of common area maintenance expenses as incentive to attract and retain them. In addition, by agreeing to a co-tenancy provision, they also attempt to protect the mid-size retailers from any potential downside that may happen in the future. Through this condition the Mall owners agree for a rent reduction if their mall goes without a big retailer for a sufficiently long time.

By doing a quick analysis of these lease features that the builders and retailers negotiate and agree upon, one can find that the rationale behind all these is to have a shared view of the business. Their retail mall business model is built on "share the risks and rewards strategy" and with one objective in mind: To keep increasing the foot traffic - the fundamental business driver. As they build their business based on this approach, features like this and many more are negotiated with greater details that make these contracts an interesting study. The adoption level of this participatory business model is so high that negotiating these contracts and managing them monthly is estimated to be a $15 billion industry globally called Lease Administration Services.

Before adapting these practices to the Indian market, one important point that needs closer attention is that all these call for transparency and accountability both by the builders and retailers. For example, the retailers should be willing to share their revenue information if they want a per cent rent feature in their contract and builders should be ready to share their operational books with their tenants if they want them to fund their maintenance infrastructure. This is a paradigm shift that both of them have to make and view each other with a long-term relationship in mind and not just a single transaction.

As the retailers and the builders start practising a participatory business model, this market segment is going to look less risky, can attract more investments from the ever-growing real estate funds and accelerate the growth. This can also expedite the infrastructure development and ultimately empower the consumer with more choices to shop. **FOCAL POINT**

**Considering the infrastructure constraints that restrict foot traffic, builders and retailers have to change their business model if they want to see significant growth and profit in the retail mall segment A participatory business model would do much to increase footfalls, the primary growth driver However, this would call for transparency and accountability, with a view to long-term relationships**