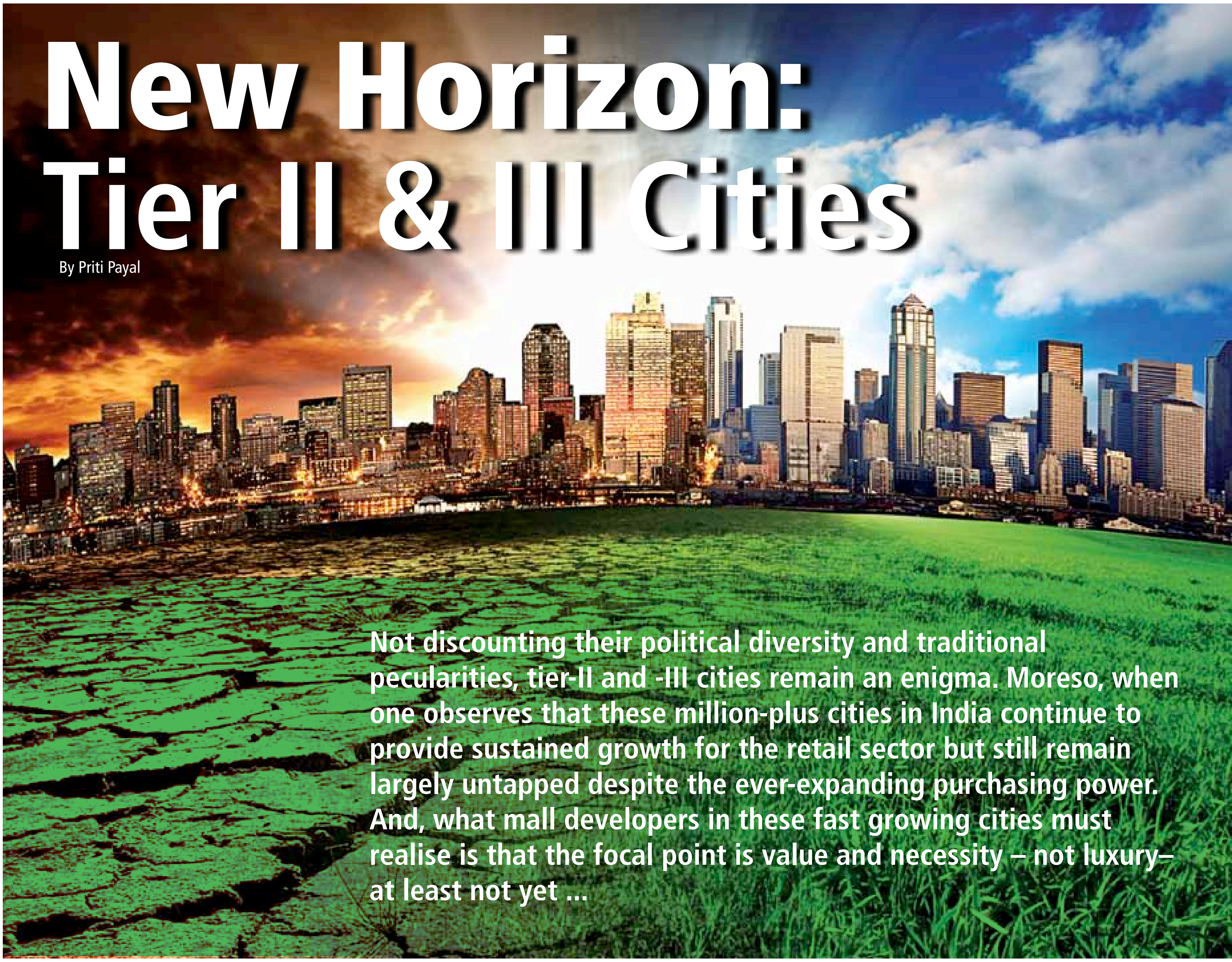

New Horizon: Tier II & III Cities

By Priti Payal

Not discounting their political diversity and traditional pecularities, tier-II and -III cities remain an enigma. Moreso, when one observes that these million-plus cities in India continue to provide sustained growth for the retail sector but still remain largely untapped despite the ever-expanding purchasing power. And, what mall developers in these fast growing cities must realise is that the focal point is value and necessity – not luxury– at least not yet ...

Gone are the days when metropolitan cities were the only focal point for shopping centre development. As the retail industry in India matures and looks for new growth strategies in the wake of the global economic downturn, tier-II and -III cities have come to the forefront. One of the major developments is the expansion of international retailers into small towns, which has forced national retailers to follow course, resulting in infrastructure development to some extent. In terms of pure numbers, many metros have shown at best a growth of 25-30 percent annually in modern retail stores. At the same time, Indore and few other tier-II cities grew at 30 to 40 percent. Many brands will be guarded and intend to make a progressive, gradual entry into these cities.

According to Arif I Sheikh, CEO, Entertainment World Developers (EWDL), "Against the backdrop of retail uncertainty, i.e., FDI, high inflationary conditions, fragmented market affordability, high supply chain management (SCM) cost compared to metros and margin pressure with roll out deferments by key brands, the retail real estate in tier-II and -III cities has shown a great degree of resilience with substantially high absorption levels." Sunil Jha, Managing Director, Shristi Housing Development, agrees and adds, "Tier-II and -III cities provide an excellent opportunity for retail real estate, as the cost of development here is lower, and the markets are untapped with tremendous potential. Despite strong spending power, spending opportunities are few here, and retail provides that opportunity to the people in these towns."

Sanjay Sachdeva, President, Advance India Projects (AIPL), feels that the shift in developers' priorities is quite evident in their attempts to offer citizens from smaller towns the best possible infrastructure. "Many surveys report that tier-II and -III cities are growing immensely, in turn supporting the upcoming growth of real estate. While cities like Mandi, Gobindgarh and Khanna are developing due to a

AlphaOne in Amritsar by Alpha G: Corp

Celebration Mall in Udaipur by AIPL

strong agro-industrial economy and strategic location (on the national highway), places like Chandigarh, Patiala and Ludhiana are growing owing to NRI investments, industrial growth and migration of skilled labour. We are amongst the first few developers with projects in these cities and have received a wonderful buyer response."

Prodipta Sen, Executive Director, Alpha G:Corp, too feels the same. He says, "The new trend for the future will be a need-based shift from metros to tier-II and -III cities and small satellite towns, which will be transformed with the availability of housing loans, upcoming malls, IT and industry parks and planned integrated townships. In the coming five years, Alpha G:Corp is looking at developing property worth ₹5,000 crores across India, the majority of which will be in the smaller cities."

METROS VS TIER-II & -III CITIES

Developers feel that although the number of brands operational in tier-II and -III cities are lower than those in metros -- and the sizes are smaller -- they exist with less or virtually no competition and much less occupancy cost. "In metros, the overall revenues are higher but malls in smaller cities are more profitable. Along with low occupancy cost, they have lower wage bills, less advertising costs, less completion time and better trading density," says Sheikh.

Sen attributes the success of the retail real estate industry in tier-II and -III cities to the success story in metros. He says, "The remarkable growth in metros and tier-I cities has instilled confidence in local and international players to expand into newer markets in smaller cities and thus capture a larger base of consumers. These consumers are open to the modern retail formats in metros, and wider coverage would mean more conversions."

According to Sachdeva, "Developers take full advantage of the cheaper real estate prices in tier-II and -III cities, which in turn leads to pushing up the retail, residential property and infrastructure sectors. Besides, it's not only people living in metros who are aware of a better lifestyle, products, services, etc; most small towns have an equally evolved consuming audience. Big chain restaurants like McDonalds, KFC, Subway, Pizza Hut, Sagar Ratna, and many more are experiencing an overwhelming response from the people here."

DEVELOPER'S CHOICE

Many developers across India have shown keen interest in tier-II and -III cities with most of their operational and upcoming retail real estate projects targeting the local consumer. Sheikh quips that it's the sheer business sense of these developers that makes them realise that sometimes less is more. "Paying twice the amount of rent in a metro doesn't necessarily give you double the footfall or twice the returns. On the other hand, half the rent does give you twice the space for almost the same number of footfalls and returns per square foot. Metros constitute only 30 percent of the total consumption, while the rest of urban and rural India accounts for 70 percent. We believe that for any sustainable, profitable business, one needs to have the 'est' factor, i.e., the biggest, largest, finest or quickest," he says.

Sen contributes, "Our thrust in large-scale retail and entertainment city centres or mixed-use developments is focused in cities like Ahmedabad and Amritsar where the developments are over the built-up area of 1 million sq.ft., thereby enabling us to make an offering like never before here." He adds that the selection of a specific site is dependent on various factors – one being the direction of the development of the city/town and the other, the catchment areas and target segments. "We try to provide scalable retail solutions that serve the long-term business aspirations of national and international retailers, while ushering in the real renaissance of retail in non-metro India," he says.

Citing the retail excellence of EWDL beyond India's metros, Sheikh says, "We positioned ourselves as the biggest mall developer of pure lease module malls in tier-II and -III cities in India, with a first-mover advantage, since we already have faith in the India retail story." He further highlights the most pertinent questions that mall developers should ask before moving to smaller cities, "Do we have the required number of shoppers in the target catchment/cities who can consistently sustain the investment? Can we reach out to these shoppers within financial resources budgeted to inform, engage and bring them to the mall and build loyalty (MARCOM)? Can these cities provide a profitable financial module? Answering these questions makes the decision rather easy."

R&D

Research is the first and the most important process that needs to be conducted by developers to determine the sustainability of projects in tier-II and -III cities. Alpha G:Crop conducted a comprehensive study not just of the existing and potential retail and related real estate market in Amritsar and Ahmedabad respectively but also of the catchment areas. "The consumers, their demographics and aspirations were the key elements of the research. The findings of the extensive research were incorporated in the planning of our respective City Centre developments in both Amritsar and Ahmedabad, thereby resulting in a strong foundation for our success," explains Sen.

Sheikh also touches upon the EWDL strategy before plunging into the business. He says, "Since we don't believe in 'Build it and they will come', we conduct both primary and secondary research at our end, which includes local econometrics and cycles, retail and residential trends, demographics, lifestyle

Celebration Mall in Amritsar by AIPL


Treasure Island in Raipur by EWDL

demographics, daytime populations and employment social class and shopping patterns, consumer expenditures and syndicated consumer research. If done right, research should reveal whether one should invest in a city or not."

But, the research work does not end here. According to Sheikh, if the answers of the above conducted research are positive, then determining the type of mall to be built, the right size and number of floors, the kind of tenants in view of the catchment, what the shoppers would like to see, what consumers and retailers will need from mall, whether the rental income from the mall will support the financial investment required for the project is of paramount importance to before starting to ensure the success of the project.

Alpha G:Corp relies on innovative systems and procedures that were set up on the basis of sustained research from the time the projects were finalised. "It is this approach that has resulted in a high level of interest from national as well as international brands for our City Centre developments – AlphaOne in Amritsar and Ahmedabad. The footfalls and customer response at both centres have been phenomenal and beyond our expectations. Towards this end, the research was very helpful in deciphering the needs and aspirations of the people of both these cities and their expectations from the malls," says Sen.

While it is feasible to conduct one's own research, many firms also outsource their work. For instance, Shristi Infrastructure outsourced their research to reputed firms in the field of real estate. Some of the aspects covered in the research work included catchment analysis, demographics, spending trends, income and shopping patterns and dynamics of market places in and around the city.

CHALLENGES

Most developers feel that if their project is the first mall in the city, then all the principal consultants may face serious challenges due to the lack of mall experience and support services in the city – right from MEP, architects and quality contractors to material vendors. Sheikh further explains, "The local authorities who need to give various approvals will struggle to understand the alien concept of malls - although I've always found them more than willing to support. Second, in the leasing phase, it becomes a daunting task to plan brands' business team site visits if the city is not on a convenient route to travel."

Highlighting the issue of location, Sen elaborates, "The location of the mall is one of the main factors that decides its success. Good visibility and access via roads are some of the main prerequisites for a mall. Zoning comes next. This essentially involves deciding which tenants would occupy what space and where. It is also very important to have the right mix of tenants at the right place so as to ensure smooth flow of customers. You have to create visibility in the market to get the desired footfalls." And, with regard to marketing strategies, Sen says, "Timely events and interactive promotional activities in the mall will ensure that you remain in the news, thereby creating curiosity and goodwill for collaborations in retail and beyond."

But, before all these factors come into play, Sheikh points out another huge challenge for retailers – the activation of fit-out teams. This poses a problem since most of the experienced contractors who know the requirements involved are based in metros and find it extremely difficult to mobilise teams to tier-II and -III cities in terms of logistics, etc. For the primary customers of these developers, i.e., retailers, the challenge is to understand relatively small but value-conscious heterogeneous catchments, the extra cost of SCM and achieve the same national price benchmarks.

Money too comes as a challenge for small town developers, as Jha of Shristi Housing laments, "Funding is a very big problem as bankers shy away from retail projects. Other challenges include capital investments, lower rentals, delayed returns and overcrowding of shopping malls in an economy where shoppers are reluctant to loosen their purse strings. Also, in tier-II and -III cities, reaching the break-even point takes much longer (8-10 years) as compared to in tier-I cities."

Sachdeva feels that the retail differentiation, merchandising mix, supply chain management and competition from suppliers' brands are few of the challenges faced by a developer. "Spending habits of consumers have changed as have their preferences. Today, they have abundant choices. This has led to a several issues for the developers, retailers and even the customers themselves. Working out a sustainable model for shopping centres in India is the need of the hour. The changing technologies and reluctance to invest in the refurbishment of malls have emerged as two of the major challenges for the shopping centre industry," he further adds.

Even after the successful launch

of a mall, the management's problems do not mitigate immediately. The first problem faced post launch is the crowd. It becomes a task to control a horde of people walking into the mall, especially if it is the first such property in that town. Sheikh explains further. "The crowd takes escalators and elevators for granted and punch the buttons till they are rendered dysfucntional, while escalators are used as children's rides. The paan and supari stains begin to grace the newly painted walls and the atrium. Unfortunately, the newly appointed staff in security and housekeeping themselves are not accustomed to handle such a large crowd." And, when a developer feels that the footfalls have stabilised, handling the VIPs too becomes a challenge because they end up expecting the developer to arrange for premium parking, theatre escorts and even armed bodyguards within the mall. Hence, every mall developer who builds the first mall in a tier-II or -III city must be patient and plan well in advance to meet such obstacles and get high dividends in the longer run.

TENANT MIX

Every city is differs with the mix of people, communities, culture and socio-economic structures, not to mention the aspirations and needs of the respective populace, which makes the proposition unique and challenging in each case. Sen points out that in tier-II and -III cities and towns, the middle class and agro-based economy expect the tenant mix to be able to cater to the value and more cost-effective formats. "Several tier-II and -III cities like Ahmedabad, Amritsar, Jaipur, Nagpur, Nasik, Pune and many others are witnessing the expansion of modern retail. However, retailers need to adjust their product mix and communication for smaller cities, as these tend to be more conservative than the metros," he adds.

Sachdeva continues, "With regard to the tenant mix in tier-II and tier-III cities, there should be around 70 percent of retailing, which should comprise hypermarkets, anchor stores, different vanilla stores and an equal proportion of local, ethnic stores. The remaining 30 percent should have an entertainment zone including multiplexes, gaming zones, etc, and a conventional food court comprising some local and multicuisine food chains according to the catchments of the mall."

Jha stresses on the franchise model to be adopted for the tenant mix in these cities, "Franchising has proved to be a successful strategy for brands in smaller towns, as it helps them pass on the investment to willing franchisees while reaching out to these towns at the same time. Retailers who add a region-specific taste to their products/stores can be a big hit. Besides, a developer should also focus on economically-priced brands with a sizable product-line."

Sheikh believes that the most important factor is the way the developer approaches the allocation of leases within mall. Most importantly, tenant mix should be hyper sensitive to catchment consumer trends, and accordingly there should be proactive, responsive and flexible leasing and placement of retailers in the mall. "If the tenant mix is right, the mall can satisfy any unmet demand for goods and services within the catchment, and shoppers from other catchments will also be drawn towards the mall, while shoppers will be retained and sales will be captured from other competing malls," he says.

MANAGEMENT & MARKETING

Organised retail is here to stay and has great potential, provided the developments are able to incorporate designs that are of international nature and an extension of the hospitality industry. Mall marketing, as we go along, will need to be enriching and fulfilling so as to enable the patrons to enjoy the complete experience. This means that retail marketing will become highly specialised, and the skill sets will become very important to succeed. The nature of marketing in tier-II and -III cities becomes all the more important in small towns and cities considering the set up of the society. According to Sen, the concept of mall culture in tier-II and -III cities is relatively new.

Sheikh explains, "Malls generally hire younger employees who work the unorthodox hours required and accept minimum wages in small cities. Getting service staff and imbibing dignity of labour becomes a challenge in tier-II and -III compared to in metros, as in small cities everyone knows everyone else, and they generally don't see dignity in working in security or housekeeping and maintenance jobs. Hence, if they are not handled sensitively, it can cause loss in turnover and affect the consistency with which the property is managed on a daily basis. All the other functions and management areas remain more or less the same."

SUCCESS MANTRA

While the mall culture in India is surely and steadily rising, the

Treasure Bazaar in Ujjain by EWDL

AlphaOne in Ahmedabad by Alpha G: Corp

Treasure Island in Indore by EWDL

MALL BASICS IN TIER II AND III CITIES

It is important to tailor a mall to the catchment rather than forcing a mall on the catchment. Some of the basic features of a mall in tier-II and -III cities are as follows:

Location with good visibility and access via roads
Right positioning and tenant mix to differentiate from other similar developments.
Size should not be too big as later it might become difficult to sustain.
Simple design, visual continuity, easy entry and exit to the parking.
Very big, bilingual signage.
Escalators and elevators both should be of very good quality and capacity with the right AMCs in place.
Anchor store should be aligned with the catchment whereby people should be able to shop at a comparatively lower rate.
If the city is not big enough, then the cinema should have a maximum of three auditoriums.
Parking needs to be based on the shoppers' vehicle assessment research, and not only cars but auto routes should be made as well.
Washrooms should be adjusted to local needs in terms of layouts and hardware.
Drinking water at the right places and twice the number of dustbins than required should be arranged.
Frequent events and interactive promotional activities in the mall.

moot question is how many of them succeed in what they set out to do. As organised retailing in India grows, tier-II and -III cities, especially, are seeing hectic activity in the mall space.

Sen explains, "Development in a tier-II and -III city is more challenging as the target audience is in the process of changing its buying and consumption patterns, and keeping that in mind, one needs to plan the development and its amenities. In a metro, one has competition, and the consumption pattern is already set, so the value proposition is a little different. However, in all cases, the 'experience' one delivers to the customer is what defines the success. Tier-II and -III cities are untapped markets where it's important for retailers to establish their brands."

Sachdeva adds, "By our estimates, a quarter of expected development in organised retailing will take place in tier-II and -III cities. These markets are witnessing strong growth in income and more significantly, changing lifestyles and aspirations along with a fundamental shift in the consumer attitude. For many smaller markets, success for retailers is predicted upon capturing the 'first delivery advantage'."

Sheikh sums up the success mantra as, "Start with good research, retail planning, the right design brief, right size, right capacity, at the right cost, right catchment, right parking, clear positioning, balanced tenant mix, sustainable entertainment options, right anchor strategy, variety, adoptability to change, wide walkways, visual continuity and special measures to take care of small city needs (like more 2-wheeler parking space). The key to success is to make the mall a place to share life experiences through consumption."

CLUSTERING

Mall clustering is the latest issue that has cropped up in the retail real estate industry with some calling it a destination and others calling it unwanted competition. The effect of clustering in tier-II and -III cities is even more tricky considering that the market is still in its nascent stage.

Sheikh warns that with only 150 brands in the country, even malls in metros are gasping for business, "Here, when we talk about clusters in tier-II and -III cities, unless the latest one comes up with a brilliant tenant mix, sooner or later one of the two or both will bleed. Similarly, if the retailers are operational in both malls or more than one mall in a small city, it would result in targeting the same catchment without any differentiation."

Sachadeva further explains, "If all malls in the same cluster are more or less the same, all of them are likely to suffer, or one will emerge successful and the rest might fail. It all depends upon equivalent excellence in operation standards, a leasing strategy that is in sync with the catchment profile, unique marketing and promotion-based events, innovative operation and marketing, community building and consumer connect. As long as your brand achieves this, business will be healthy. If you let your guard down on any one of these, then clustering will get to you."

At the end of the day, it all depends upon the uniquness of the property. "It cannot be predicted in a formatted manner, but in the end, the customer decides which mall to patronise due to its comfortable approachability and the brand mix it provides. As the market matures and the initial curiosity factor fades away – the buyer settles with one or two malls in the catchment depending on his/her requirement. If different malls in the cluster have different offerings, then it will benefit all malls," adds Sachadeva.

Sheikh believes that every story always has a positive side. He says, "If both or all malls offer distinct advantages and reasons for shoppers to visits them, then all the properties will prosper. We all know that there are 8 million small outlets in these small cities but with less than even 150 malls in tier-II cities. If a sufficient number of brands is available and developers plan the strategy right from design to mall management, then cluster or no cluster, all the mall developers will fetch a decent ROI."

INFRASTRUCTURE

The basic problem faced by the industrialist in smaller towns and cities is the lack of proper infrastructure. However, developers see a ray of hope here, too, and expect it to become better with each passing day. According to Sen, "Infrastructure, which has been a problem area in small towns and has stood in the way of retail, is improving with the wave of real estate development transcending metros. One of the major problems in most parts of the country is the lack of town planning, due to which there is very limited world-class retailing space available – a problem that gets magnified in smaller towns. But, with several malls set to come up in small towns in the near future, the opportunity for brands to establish themselves is bound to get an exponential boost."

Sachdeva too insists that "The

Asansol Sentrum by Shristi Infrasturctures

infrastructure of tier-II and -III cities has improved considerably since nowadays most of the tier-II cities are well connected with all the major cities. Due to the movement of skilled labour in tier-II and -III cities, there has been an overall development of these cities including in power, roads, housing, etc. As the peripheral infrastructure including transportation, education and employment improves in these cities, the real estate industry is seeing corresponding growth. Being a highly fragmented market, affordability of homes has made it lucrative for customers."

Sheikh further adds, "Limitations in terms of good land parcels are common across the country, and acquiring one comes at a premium, but it is certainly achievable in tier-II and -III cities at a much lesser cost than in metros. The supply chain is another issue, but off late, better road networks across the country have taken care of many key cities. Overall, there are more opportunities than limitations in emerging India."

GOVERNMENT'S ROLE

Although the organised retail market has not yet achieved its full potential, it is expected to grow manifold by 2015. The sector already contributes 10 percent of the GDP. There are about 300 new malls, 1,500 supermarkets and 325 departmental stores currently being built in cities across India. This suggests that the potential for growth is immense. However, the retail real estate industry suffers due to a high interest cost and discriminatory treatment, despite it being the most productive (78 percent) in terms of GDP contribution for every Rupee invested, apart from being a high employment provider. Lack of financial resources makes the retail space components costly, which in turn impacts the very principle of affordability for retailers who want to expand but can't.

Sheikh believes that the government needs to play a role at the national level first; only then can one dream of supportive role to malls in small cities. "We are the biggest mall developer of Central India," he says, "And our observation is that there is vast disparity in the penetration levels of organised retail in tier-II and -III cities in India. (Metros: 20-25 percent; Pan India: only 5 percent). The government could consider introducing some tax holidays/fiscal incentives for retailers willing to expand into these cities, similar to those available to manufacturers and exporters operating in such areas. In these cities, trading hours, law and order, better town planning, traffic routing are the only issues that need the local authorities' support."

Sen agrees with Sheikh, "The governments, both at the Centre and in the states, need to seize this opportunity for greater employment options, smoother logistics, enhanced overall growth by focusing on creating a friendly environment for the long-term growth and sustainability of this sector. The success and sustainability of the retail boom would also be impacted by real estate reforms like the rationalisation of realty markets, lowering of entertainment taxes, increased sources of funding real estate, foreign direct investment, import norms and uniformity in taxes for the organised and unorganised sectors."

Finally, highlighting the issue of tax exemption, Sheikh says "I wish schemes like tax holidays would be introduced to generate stock under the tier-II and -III retail category. For instance, all projects in cities with a population less than 10 lakh could be exempted from taxes. Such provisions under the Income Tax Act could show huge results if there is reduction in the overall income tax slabs for individuals and will definitely result in ensuring a higher purchasing power in the hands of the consumer and consequently increase the demand for consumer goods and retail growth."

FUTURE

In the end, the developers feel that even with the economy not in its best form at the moment, immense potential, novelty for shoppers coupled with entertainment and disposable incomes will always ensure a bright future in tier-II and -III cities. Sachdeva explains, "Tier-II and -III cities will continue to be the hotspot for real estate investors despite the slump. These cities will emerge as the most sought-after real estate destinations in the coming year, and one of the major factors leading to their growth is the saturation of metros."

Sen elaborates, "Retail will continue to grow rapidly to meet the needs of a fast-growing middle class segment, demanding higher quality shopping environments and stronger, recognisable brands. Tier-II and -III cities are in the midst of a retail revolution, where supermarkets and hypermarkets are booming, offering a wide array of choices and cool comfort to shop. For retailers, doing business here means lower rentals and other costs."

Jha believes that if the brand mix is dynamic and maintenance is good, tier-II and -III cities hold the promise of a great future. "The metros are all packed with malls and high- street outlets leading the brands to explore tier-II and -III cities. This trend prevails not only in the apparels sector but in all the sectors including services to pre-schools. Besides, consumption in smaller cities is rising, and the rents are not too high."

Sheikh concludes by citing the example of Treasure Island, Indore, "Until recently, retailers were only looking at metros for expansion and new properties, but once they look at our portfolio of malls in tier-II and -III cities and the trading density there, like in Treasure Island Indore – which is in the top 3 on a nationwide basis – then they will surely believe that the future in tier-II and -III cities is very bright." ●