SMARTPHONES, SHOWROOMING IMPACT COSTS

Smartphones lead the way in making mobile a key player in consumer purchases in-store and online.

By Morris A. Ellison, Esq.

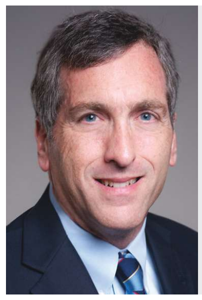
The battle between physical stores and online retail rages on, but the recent explosion in smartphone usage is blurring the battle lines. Using smartphones, consumers in a store now can simultaneously shop and compare pricing and product availability at competing stores or online. The practice is sometimes referred to as "showrooming." Increasingly, retailers must simultaneously invest in a combination of brick-and-mortar stores, websites, digital marketing and merchandise delivery to sell goods.

Only the real estate component of that infrastructure is subject to property tax. If property owners identify the portion of store sales attributable at least partially to online shopping, they can argue for taxable property values more accurately based on the remaining sales volume attributable to a store's physical location and condition.

Retailers that think mobile is a channel use the wrong metrics to measure the smartphone's impact on retail. Smart retailers focus on the impact on overall business rather than trying to measure only app downloads or channel sales.

Extrapolating a retail property's value from base rent is relatively easy, but what happens when rent is based on sales? How do sales that take place in the store via smartphone, or online transactions that stem from a store visit, affect percentage rent?

Assessors and appraisers don't yet have satisfactory answers to these questions and developing appropriate metrics is challenging. Taxpayers can help shape the debate, and their own tax liability, by understanding the problem.



Morris A. Ellison, Esq.,
Partner,
Womble Carlyle Sandrige & Rice LLP

Digital Influence Spreads

The lion's share of U.S. retail sales continues to revolve around physical stores. Forrester Research reports that in 2015, e-commerce sales totaled approximately $334 billion, while off-line sales totaled $2.9 trillion, more than eight times more. However, many off-line sales were digitally influenced, meaning shoppers connected with digital touch points, particularly mobile phones.

Forrester estimates that $1.2 trillion of U.S. retail sales in 2015 were web-influenced, and that by 2020, $1.6 trillion of all off-line retail sales will be web influenced. The penetration of online buyers using smartphones increased to 86 percent in 2015, up from 54 percent in 2011, Forrester found.

Shoppers want to receive products quicker and cheaper than ever before, but still prefer to shop in physical shores in order to touch merchandise and obtain products immediately. Successful physical retailers combine physical stores and digital tools, enabling customers to touch and receive goods in a more cost-effective way than ever before.

Physical retailers must realize the key role smartphones play in unlocking sales. American adults use smartphones to locate stores and to check store hours, requiring retailers to keep websites current. Forrester estimates that in the first quarter of 2016, more than one-quarter of U.S. online mobile phone users ages 18 to 34 used their phones to compare prices online for products they were considering buying.

Shoppers also research product information on smartphones, often while in a store. Retailers, therefore, must monitor price variances and adjust prices in real time, against both physical and virtual competition.

Physical retailers also need to address perceived problems with off-line shopping, such as long lines and out-of-stock merchandise. Some sophisticated retailers have addressed these issues by developing store-specific data. Forrester reports that companies such as Target and The Home Depot now direct shoppers, via smartphones, to look for items in specific locations within stores, thereby reducing wait time and frustration. Nike store employees can look up inventory and make sales immediately with their smartphones.

Shipping continues to pose a problem for both physical and virtual retailers. When the product is in stock, the physical retailer does not have a problem. However, maintaining inventory in stores potentially imposes the added costs of the inventory itself, additional rent and associated property taxes.

In January 2016, *The Wall Street Journal* reported that Gap, Inc., which includes retailers Banana Republic and Old Navy, was narrowing its free shipping window to 5 to 7 business days, down from 7 to 9 business days. Is this enough to satisfy the demands of consumers who expect immediate delivery of products, particularly from physical retailers?

Challenge to Retailers

Physical retailers face three very expensive budget items: associates, real estate occupancy costs (including taxes) and inventory. They must create a more pleasurable, yet competitive, shopping experience in order to beat digital competitors. Stores must become increasingly immersive and engaging experiences that enable customers to do everything from trying on wearable goods to playing with and testing products, or attending cooking classes and food demonstrations. The importance of enhancing the shopping experience in physical stores often means creating easy availability to other amenities such as restaurants and coffee bars.

While it may seem counterintuitive, the quality of a retailer's online presence will influence sales, and hence the underlying value of the retailer as a tenant in a shopping center. Developers need to attract retailers who simultaneously focus on brick-and-mortar store sales, websites, digital marketing and merchandise delivery to sell goods. Percentage rent clauses in leases must appropriately capture sales.

All of this takes money and increases the complexity of measuring costs. Costs, such as property taxes, play a key role as retailers compete for sales and profits. Online retailers generally pay property taxes for distribution centers but can often reduce this cost by obtaining tax incentives, such as fee in lieu of tax agreements. Physical retailers, which often have a greater impact on the local economy, have less leverage to control property taxes. They face the challenge of showing assessors how mobile technology and e-commerce, not location alone, impact sales.

In January 2016, Forrester reported that "too often, companies measure what they can, rather than what they should, because they lack the analytics to generate the insights they need. Retailers track mobile sales rather than influenced sales because they can, and, more often than not, do treat mobile as a [separate] sales channel."

This is precisely the problem tax assessors and physical retailers face in measuring mobile technology's impact on a retail property. The assessor's job is to value the real estate, not the business, which is increasingly affected by mobile innovation. Theoretically, one can use only in-store sales volume in the valuation but to what degree is a store-front simply an advertising medium — like a billboard. Stores can encourage customers to order while browsing at the store but have it shipped to their house and/or pickup at a nearby location that has lower property tax, possibly a warehouse on a side street.

Increasingly, retailers must balance between the physical and the virtual, with the smartphone serving as the key touchpoint. Retail success is still about location — location of the actual shopper inside or outside the store, at home, at work, at a competitor's store or on a website or smartphone — it's just not about physical storefronts anymore.

Morris Ellison is a partner in the Charleston, S.C., office of the law firm Womble Carlyle Sandridge & Rice LLP. The firm is the South Carolina member of American Property Tax Counsel, the national affiliation of property tax attorneys. Morris Ellison can be reached at mellison@wcsr.com.