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## **Shopping Centre Europa – When Threats Become Opportunities**

### Teaching Notes

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## Synopsis

In December 2009, Antanas Anskaitis, country director of BPT in Lithuania, had hoped for some seasonal respite from the downward trend in trade, but the latest statistics confirmed his fears: footfall through the shopping mall was down 15% on the corresponding period the previous year and the average turnover of all stores in the mall was down 54% on the previous year. The economic crisis had become an issue/thread for Europa shopping centre, and its owner, Baltic Property Trust Secura (BPT). For the first time since its opening in Vilnius, the company faced rapidly decreasing flows and turnover. Falling revenues meant that most stores within the shopping mall had been struggling to maintain their cash flow and profitability.

It was of no comfort that many other shopping mall landlords in Lithuania and around the world faced exactly the same cash flow pressures. A coordinated and collective approach to resolving the problem was required and time was running short. Due to economic downturn and high competition in the Vilnius retail segment, the owners of the centre are facing issues such as keeping the vacancy low and tenants as happy as possible, as well as increasing the flow of customers, in order to get planned cash flow and achieve strategic goals.

BPT Asset Management is a property investment management company, established in Denmark in 2001. By 2005 it had grown to be a leading commercial real estate investor in the Baltic Sea region. BPT developed five property funds totalling more than EUR 1 bn in assets under management. By targeting only professional investors (the client base is primarily North European), BPT developed a reputation for safe and professional investment practices and exemplary management of its assets. One of its funds BPT Secura is the owner of shopping centre Europa since autumn 2004.

## Teaching Objectives

This case has three teaching objectives:

- (i) To apply knowledge of retail segment functioning specifics and discuss major drivers in shopping centres business.
- (ii) To apply knowledge of strategic management principles in retail property management in various economic and market cycles.
- (iii) To apply knowledge of real estate investment and evaluate major value determinants, investment and principal risks when investing into shopping centres.

## Use of Case

One of the major themes in this case is how to manage a modern and well-located shopping centre under different circumstances – when economy is growing, and competition is low versus economic downturn and high competition in the segment. *How to transform threats into opportunities?*

## Discussion Questions

Topic 1: What are major aspects of retail segment vs. other types of real estate? What are the major drivers in the retail market? What may happen if anchor tenant leaves SC? What happens if shoppers spend less and less? How to attract a shopper/customer, when every SC is fighting for customer?

Topic 2: What are major value determinants of the shopping centre? Are they constant or subject to change when situation changes – what are the most important aspects when economy is growing/declining, competition is low/high?

Topic 3: What are major risks and specifics when investing into retail segment? What are major investors' risks, value drivers and principal risks?

## Organizing Discussion

The case may begin with a brief introduction to set the stage. Below is the suggested time line for teaching the case.

Introduction	Identify the key discussion points to be covered	5 minutes
Topic 1: Major drivers in retail market	Address teaching objective 1.	30 minutes*
Topic 2: Strategic management of SC	Address teaching objective 2.	30 minutes*
Topic 3: Investment into SC issues	Address teaching objective 3.	30 minutes*
Conclusion	Summarize the discussion	10 minutes

\*time is planned for one activity to be chosen from the provided options (see Teaching Plan section).

## Teaching Plan

### *Topic 1: Major drivers in retail market*

As stated by ICSC (Shopping center management, 1999), it has often been said that the dynamics of retail real estate are three-dimensional, while those of most other real estate formats are two-dimensional. The reasoning behind the comparison is that most nonretail real estate – office, apartment and warehouse formats, for example – are based upon a simple landlord-tenant relationship. Shopping centres and other retail real estate formats are based upon a more complex dynamic which includes the same two parties plus customers, who must patronize tenants' stores in order to the process to work – thus creating a three-party process. The complexity results from the additional challenges related to finding the appropriate assortment of tenants who can effectively attract enough consumers to support the business plan, including paying the landlord's rents. Moreover, in most cases, the fourth party – lender –

plays important role when providing capital needed by shopping centre owners to build, purchase or finance a centre.

Shopping centres are also unique in the real estate market in terms of the development and change they typically evolve. SC adapt to various challenges and opportunities more rapidly than the most of other real estate formats. Therefore, complex three-party retail dynamic requires that landlord and tenant (merchant) work together to achieve success with a third party – consumers.

### **Market Drivers**

Explore differences among other real estate types (offices, industrial, residential) market indicators and drivers.

Begin by asking students to make a list of major drivers of SC segment. Which are the most important, are drivers the same when situation is changing? Ask students to prepare a short market analysis of Lithuanian economy and look for trends important for SC segment.

*As a guideline for analysis the below structure could be useful:*

*The major driving forces for the growth of the retail market in Vilnius are:*

- *one of the lowest unemployment rate in the country,*
- *higher average income than other Lithuanian cities,*
- *increasing number of local and foreign visitors,*
- *changing shopping habits (more and more people shop in the shopping centres than in retail streets).*

*The major threats for the growth of the retail market in Vilnius are:*

- *decreasing consumer spending power due to economic situation,*
- *high competition in retail segment,*
- *SC market saturation.*

### **Market Indicators**

What are major market indicators (vacancy, rental levels, prices, new stock, market absorption)? Discuss the major dynamics of the above mentioned indications in all market segments. Which SC in Vilnius is the prime competitor for Europa SC? Why? What is the situation in that centre?

Prepare a short market analysis for a foreign investment fund to present what is the retail market situation in Lithuania and Vilnius now. Are the Vilnius and the Lithuanian retail market the same or different in some aspects?

*Topic 2: SC management of SC*

### **SWOT Analysis of Europa SC and the Vilnius retail (SC) market**

Ask students to make the Vilnius retail (SC) market and Europa SC SWOT analysis. What are the major threats and opportunities? What is the market potential? Which shopping centres are major competitors for Europa SC? Why? How can competition be managed?

### **Lease Contract Negotiation – Role Play**

Ask students to play the roles of major tenant and SC owner when negotiating the lease agreement terms. What would be the major arguments of both sides? Allow up to 15 minutes for negotiation/discussion and then sum up indicating the major peculiarities of SC Europa and potential for making it more attractive for tenants.

### **Marketing Plan for SC Europa**

Prepare a Marketing plan (taking into account SWOT analysis prepared by students) for Europa. Who is the target customer of the centre? How can threats be converted into opportunities? What could be the first 5 steps SC manager shall take to make it more attractive and to increase spending of customers.

### *Topic 3: Investment into SC segment*

#### **Bank and Owner Meeting**

Make three groups of students representing the bank, owner of SC, potential investor/buyer. Each group has different goals in the coming meeting – the bank wants to finance the transaction, the owner wants to keep cash flows constant, make SC attractive to tenants and customers in the long run, and finally sell the property at the highest price. Investor want to invest certain amount of money in the Baltics and is looking for different options, one of them is shopping centre in Vilnius. Let students prepare for the meeting and play it.

What can be learned from this case point? What are major risks for investors and how they can be overcome?

As a hint to discuss investment risks, the following information might be used.

#### **SC investments** (adopted version of J. Dasso)

<i>Main Value Determinants In SC segments</i>	<i>Investment Characteristics</i>	<i>Principal Risks</i>	<i>Most Likely Investor Type</i>
Community growth  Effective demand (population, income)  Convenient location relative to competition	Moderately active  Liquidity limited (in LT – moderate)  Moderate leverage  Rate of Return by	Start Up: getting proper tenant mix  Management: need to provide adequate level of service	Reasonable wealthy – need to make large equity investments  Investment funds mostly

Shopping habits	periodic income and value appreciation	Vacancies	
Adequate parking		Competitive facilities	
Tenant mix relative to spending patterns	Tax Depreciation (not in LT)	Obsolescence	
Effective lease negotiation	Ordinary and Capital Gains Taxation (not in LT)	Economic situation changes – market risk	
		Liquidity risk	

### Relevant Theory and Academic Literature

1. *Shopping center management* (1999) ICSC, New York
2. J. Dasso, J.D. Shilling, A.A. Ring (1995) *Real Estate* (12<sup>th</sup> edition) Prentice-Hall International. 1995.
3. McKenzie, D. J., Betts, R.M. (2008) *Essentials of Real Estate Economics* (Fifth edition), Cengage Learning.

### Property Information

<i>Location</i>	Vilnius, Lithuania
<i>Type of Property</i>	Fashion centre (traditional, small, comparison-based)
<i>Ownership</i>	RE Investment trust
<i>Total Area</i>	22,600 sq. m
<i>Rentable Area</i>	17,500 sq. m
<i>Number of Tenants</i>	116
<i>Parking</i>	1200 (used together with business centre)
<i>Date of Completion</i>	2004

Shopping centre Europa is one of the most popular and modern shopping centres in Vilnius. Situated in the new and most dynamic business district, Europa serves as a place to meet, eat and shop under one roof. Being next to Vilnius County and City Municipality as well as to major business centres in the city, the shopping centre is being visited by upper-level income customers everyday.

Since opening in 2004, shopping centre Europa has been a fashion and style centre dedicated to working professionals to enjoy in style shopping. Right mix of tenants combined with convenient layout and friendly atmosphere makes Europa the most attractive place for shopping. Every square meter is occupied by selected high quality and well-known international and local brands to fulfil customers' needs.

### The Vilnius retail market

Shopping centres have existed in the Lithuanian market only for several years (the first modern shopping centre was opened in 2002). The major shopping centre developments took place in 2002-2004, followed by a slow-down in 2005-2006. However, this slow-down was not caused by

the oversupply or doubts about market capacity to absorb the new supply, as it may suggest the figures of 2002-2004. There were few underlying reasons to explain it. Firstly, active residential developments were ongoing and enjoying shorter pay-back periods and higher profit margins. Secondly, developers after making first steps in the capital city later on have directed their investments and main forces into the secondary Lithuanian cities thus causing active retail space expansion in Siauliai, Kaunas and especially Klaipeda.

### **Main Shopping Centres in Vilnius**

<b>Shopping Centre</b>	<b>Opening Year</b>	<b>Total Area, sq. m</b>
Akropolis	2002-2004	100,500
Europa	2004	22,600
VCUP	2003	19,800
BIG	2006	18,800
Mada	2003	18,600
Gedimino9	2007	16,600
Domus galerija	2003	14,000
Mandarin	2005	9,000
Flagman	2004	7,000
Panorama	2008	65,000
Pupa	2008	6,300
Ozas	2009	93,000

The demand for space in modern shopping centres came from both local and international retailers. International retailers were interested in both Lithuanian and Baltic market in general, especially in 2004-2007, however mostly limiting their expansion to capital cities. The main reasons for that are the following: overall increase in purchasing power throughout the region, maturing retail market and changing shopping habits. Nevertheless, only few international retailers work directly in Lithuania. Most international brands are represented through franchise agreements. The main reason for this is the size of the market. However, such international retailers as H&M, IKEA, are planning to open their first stores in the Baltics (Riga and Vilnius) by 2013.

### ***What Happened Later?***

Triggered by major new openings in 2010, the tenant mix reform gathered momentum from the beginning of 2011. The year featured a number of replacement and reconstruction projects - totally, one third of the lettable area was converted into new or upgraded shops, which are able to offer the customers an extravagant environment, top quality goods and collections, as well as the highest standard service and personalized attention.

The ground floor had been accommodating an excessive versatility of retail operations, therefore during 2010/2011, the floor was restructured by re-enforcing relevant segments. The floor is now a good destination for fast-and-daily-consumption goods and services: restaurants, bakery, coffee-shops, grocery, cosmetics, sweets, gourmet, accessories, pharmacy, optician, etc.

A number of apparel stores were opened on the second floor: Laurel, Guess by Marciano, More&More, Ralph Lauren, Baldessarini, Otto Kern. Together with the existing Gant, Marc

O'Polo, Stefanel, Samsonite, Lancel, Gerry Weber and a number of other stores, the floor now is an attractive destination for fashion shoppers.

In 2011, a number of re-arrangements were completed also on the 3rd floor of Europa. The tenant mix was strengthened by a large sportswear concept, a new 350 sqm bookstore with an integrated library and café, as well as three new shops for kids and parents and a new restaurant to replace the former concept very much in need of an upgrade.

All the afore-said functional improvements in the tenant mix shall generate an extra rental income of approx. EUR 140'000 per year. Moreover, this significant upgrade of the tenant mix resulted in annual growth of footfall (+15% in 2011 vs. 2010) and a marked upward trend in aggregate centre turnover (+12 % in 2011 vs. 2010). (BTP information, January 2012)