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The decline of established American retailing threatens jobs

A love affair with shopping has gone online



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IT DOESN'T look like much but Staten Island Mall is optimism in a cement box. Like all such retail spaces the temperature is carefully calibrated. Bland pop music wafts down beige halls. Its biggest tenants are America's unholy trinity of struggling retailers: Macy's, J.C. Penney and Sears, all of which are closing stores. This mall, however, is undergoing a rebirth.

Gangs of builders are hard at work on a 235,000-square-foot expansion, adding nearly a fifth to the current floor space. This will house more shops, a new cinema and restaurants. In the old part of the mall, struggling tenants are making way for new ones. Sears will soon occupy just a quarter of its former space; two European discounters, Primark and Lidl, are taking its place. GGP, a real estate investment trust (REIT) that owns the mall, reckons that the \$231m it is pumping into the expansion will bring healthy returns by 2019. "Good real estate wins," says Sandeep Mathrani, GGP's boss. It helps that the mall is the only one on a populous island.

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Elsewhere, the future of American shopping looks in much worse shape. The Shoppes at Buckland Hills near Hartford, Connecticut, is also owned by GGP but there are no big plans to invest here. The car park is almost empty. It is unclear if the branches of J.C. Penney, Macy's or Sears in the mall will remain open or, if they

shut down, whether new tenants will replace them. The mall faces relentless competition both from e-commerce and other shops nearby. An assistant sits patiently at a cash register, waiting for customers. "Day by day," he sighs, "it gets worse."

Mall adjustment

Therein lies the problem for America's retailers. Not every mall or shop is dying. For now, store-occupancy rates are healthy. Nor have consumers stopped shopping. But they are spending money in new ways to the benefit of other businesses, such as restaurants, hotels and e-retailers, in particular Amazon. As a result, a giant established industry is descending into crisis.

Last year about 4,000 shops closed their doors for good. In 2017 more than twice that number may shut, says Credit Suisse, a bank. Consumer confidence is strong and unemployment is at its lowest level in a decade, yet S&P Global Ratings expects retailing defaults this year to surpass those in 2009 when the economy was in the depths of a recession.

The most important question is how far and how fast the industry might sink. This has implications not only for retailers and retail-property companies but also the financial firms that have given them money, from banks to life-insurance companies. The total amount of capital, both debt and equity, supporting American retailing (excluding Amazon) now exceeds \$2.5trn, according to *The Economist's* tally.

The turmoil may also engulf millions of workers. The retailing industry employs 15.9m people, accounting for one in nine American jobs. The workforce has expanded by about 1m since 2012, yet a reversal looks inevitable. Since January the industry has shed 50,000 jobs, with more lay-offs sure to come. Mr Mathrani reckons that, for shopping centres to match demand, 30% of space should close permanently. In one particularly gloomy scenario, all retail property would shrink by as much. If staff dropped by the same proportion, 4.8m would be at risk of the sack—around half the number of American jobs lost during the financial crisis. Eventually, even more may be laid off, as remaining stores cut costs through automation.

Our examination of property data from CBRE, a brokerage, suggests that some cities with fewer shops per person, such as New York and Seattle, may fare better, but that few parts of the country will be untouched. Retailing accounts for at least one in ten jobs in every American state. Not since the decline of manufacturing began in

the 1980s has an industry with so many workers faced such a profound shift.

These trends are not confined to America. Department stores in Japan are closing their doors. The Japan Department Stores Association estimates that national sales at such shops were worth ¥8.9trn (\$63bn) in 2000, but fell to ¥6.2trn in 2015. Across the world, 192m retailing jobs are threatened by automation, according to estimates by the Eurasia Group, a consulting firm. However the change is particularly dramatic in America because, until very recently, the country's retailing industry had enjoyed such astounding growth.

Over the course of the 20th century retailers first built glistening downtown emporiums, and then expanded from main streets and city centres to the suburbs. Malls were conceived in the 1950s by Victor Gruen, an Austrian immigrant, as a new enclosed version of a town square. Sam Walton built his first Walmart in Rogers, Arkansas, in 1962 and would soon open big box after big box, each store making up in value for what it lacked in charm. The company's annual revenues still outstrip those of any other listed firm in the world.

The pace of development has ensured that America is now packed with stores. The country has about five times as many shopping centres per person as Britain. Retailing accounts for 31% of all commercial property, according to Cushman & Wakefield, a brokerage, the equivalent of more than 150,000 football fields.

The shop-building boom brought with it plenty of jobs. As other sectors that had once thrived swiftly waned, retailing employment remained stable, at least until recently. Foreign workers may make goods but American cashiers still sell them. Retailing jobs surpassed those in manufacturing 15 years ago and now exceed them by 28%. Wages may be low for salespeople—\$13 an hour on average. Nevertheless, a job in retailing is a reliable way for those with little training to earn money. Just 20% of shopworkers have a university degree.

Americans' changing shopping habits threaten all this. Consumers are spending more on eating out, holidays and, to their chagrin, health care. They are spending less on clothes, typically the main offering of department stores and malls. When shoppers do buy a dress or jacket, they want a bargain, an attitude spawned in the recession and ingrained in the years since.

Although that has eaten away at sales for many traditional retailers, it has helped others such as Inditex's Zara, a fast-fashion behemoth, and TJ Maxx and Ross, which sell last season's designer styles at a discount. Such shifts in fortune would not have been enough to trouble the industry in the past. Shoppers have always ensured the survival of the fittest: ailing shops inevitably made way for more popular ones and consumers gained. But the rapid ascent of e-commerce, on top of these other trends, changes the game.

The share of retail shopping done online jumped from 5.1% in 2011 to 8.3% last year. That figure disguises the damage e-commerce has done to specific parts of retailing (see chart 1). Two-thirds of books, music and films are now purchased

online, as well as over two-fifths of office supplies and toys, according to Cowen and Company, a financial-services firm. For years retailers assumed that Americans would still prefer to buy clothes and shoes in a shop rather than from a website—consumers would surely want to feel the texture of a frock's fabric, for example, and ensure a good fit. But a growing number of shoppers are happy to do without and shop from home. About a quarter of clothes and accessories are now bought online.

Amazon has both benefited from this shift and accelerated it, setting new standards for choice and service—in 30 American cities, members of its subscription service, Prime, can receive goods within two hours, at no extra cost. The harder retailers try to keep up, the less profitable they become. Spending on shipping and digital infrastructure chomps at margins even as retailers' online sales cannibalise those from their stores.

For every percentage-point increase in their share of e-commerce sales, a retailer's margins shrink by about half a point, according to estimates by Morgan Stanley, a bank. And still Amazon races ahead. Last year it accounted for over half of all new online spending in America.



The result is that America's rich landscape of shops now looks like a dangerous glut. Since the start of 2016 Macy's has announced that it is closing 140 shops. J.C. Penney said in March that it would shut 138. More closures are sure to come. Department stores' floor space has contracted by 11.5% since 2006, but sales have shrunk more than twice as fast, according to Green Street Advisors, a real-estate research firm (see chart 2). To reach the inflation-adjusted sales productivity of 2006, at least another 800 department stores would need to close, reckons D.J. Busch at Green Street.

Even that might not solve retailers' problems. Shutting unproductive stores is fraught with peril: shops risk losing their customers to competitors, both online and off. Karen Hoguet, Macy's chief financial officer, has noted that when a chain closes a store in a particular area, online sales in that region often drop, too.



Department stores are not alone in their woes.

Private-equity firms were once able to boost profits

at a middling retailer by hiring new managers and untangling supply chains. The Shoppes at Buckland Hills features a parade of private-equity bets: Claire's, owned by Apollo, rue21 (Apax) and Gymboree (Bain Capital). All have too few shoppers and too much debt. If that continues they may go the way of Payless Shoe Source, owned by Blum and Golden Gate Capital, which declared bankruptcy last month.

Trouble in store

Taken together, these changes plague a growing number of retailing properties. Small strip malls—lines of stores united by a car park—have fared better, says Garrick Brown of Cushman & Wakefield, thanks to their mix of shops and restaurants as well as dry cleaners, dentists and other services. But high streets in towns and cities, malls and larger strip malls, where chain stores proliferate, are under pressure.

Malls, which account for 8% of America's retailing space, are particularly vulnerable. When a department store leaves a mall, other tenants are often allowed to renegotiate or end their leases. So if a big store closes, the prospect that fewer shoppers will visit makes it more likely that others will abandon the mall, too. Ailing malls might seem like good news for nearby competitors but they should not feel too smug. Struggling malls, in an effort to fill vacant spaces, are wooing businesses that now occupy larger strip malls, such as grocery chains and discounters. It is unclear if there are enough of these to go round.

The upheavals of the retailing industry give good reason for worry to a growing list of companies, investors and workers. The threat to retailers and the property companies that serve them is clear. American retailers (excluding Amazon) have a market value of about \$1.6trn. The best-managed ones, such as Walmart and TJX, which owns TJ Maxx, look robust. But some of that \$1.6trn will vanish, despite efforts to close weak stores and improve those that remain.

The share prices of the two biggest retailing REITs, Simon Property Group and GGP, have already plunged by about a quarter since July. They are now investing in their best malls, seeking to replace sickly retailers with popular new ones. "We actually view this to be the biggest upside in our business," says Mr Mathrani. They have also tried to protect themselves from the worst performers. Simon spun off its weakest malls into a separate firm in 2014. GGP did the same in 2012. Those spin-offs are now discarding their most rotten malls.

Beyond retailers and REITs, it is less clear where the brunt of the travails will be felt. The sale of bad malls has shifted that problem to a variety of private investors. The ownership of strip malls and free-standing stores is fragmented, making it hard to work out who would be damaged as the decline of retailing quickens.

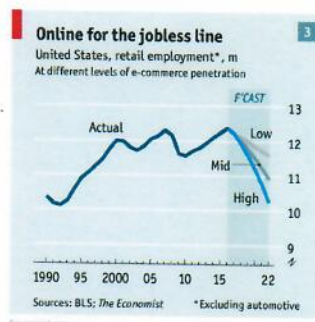
Talking shop

The picture for debt is equally muddy. Bank of America is unusual in that it discloses its exposure to retailing: about \$50bn, equivalent to more than a quarter of its core capital. No comprehensive tally of retailing-property debt exists. According to Morgan Stanley, most loans last year came from regional banks, commercial mortgage-backed securities (bonds backed by cash flows from commercial property), national banks and insurers. *The Economist's* examination of data from Bloomberg, the Mortgage Bankers Association and TreppAnalytics, a firm which tracks commercial mortgage-backed securities, suggests that the combined debt of retailing companies and retailing property is roughly \$1trn. However the

market's opacity means that the impact of any losses is hard to predict.

The effect on the 15.9m people who work in retailing is obvious, and already visible. Clothing, office-supplies and department stores have seen some of the heaviest job losses. Some jobs, such as selling groceries, are safer—slim margins and the logistical challenge of delivering perishable, bruisable food means most shoppers still buy in stores. *The Economist* has calculated what might happen to retailing workers (excluding those who work in car and fuel sales), if e-commerce grows as Cowen expects. Assuming that employment in stores rises or falls with changes in those stores' sales, and that labour productivity improves at historical rates, retailing jobs could shrink by 12%, or 1.5m jobs, by 2022. If e-commerce's share of sales is 50% greater than what Cowen expects, employment could fall by 17% (see chart 3).

Even these assumptions may be rosy. Retailing jobs are threatened not just as companies close shops but as the remaining ones try to beef up their profitability. Lowering labour costs can take many forms. In a recent study, LEK, a consultancy, pointed to Aldi, a German grocer, which has taken simple steps such as requiring shoppers to pack their own bags. Kroger, an American supermarket chain, has invested in an automated system to regulate and report refrigerator temperatures, so staff do not have to track them manually. Amazon is testing digital tools that allow shoppers to pick up goods in a store and leave without stopping at a cashier.



The boom in e-commerce is sometimes touted as an alternative for shop workers facing the chop. Indeed, e-commerce and warehouse jobs are a growing share of the workforce: they are now equivalent to 10.1% of retailing employment, up from 8% a decade ago. Amazon is hiring at a furious pace. In January the firm said it would add 100,000 workers in America by July 2018. These cheery figures may not offer much comfort in the long term. At its current pace, by July 2018 retailing will have shed three times as many jobs as Amazon is due to create.

Trends in job advertisements also offer only fleeting solace. Listings scoured by Burning Glass, a job-analytics firm, initially suggest a positive trend: from 2014 to 2016 the total number of vacancies in traditional retailing dropped, but this was offset by postings for e-commerce, warehousing and tech jobs in retailing. Yet the skills required for retailing's new jobs differ from those needed for old ones. Burning Glass found that 78% of e-commerce postings want applicants with a university degree, compared with just 12% in traditional retailing. Even warehouse positions demand more training: 53% of jobs in automated warehouses also require a degree.

Couriers need less training to ferry goods to customers' doors. Their ranks have grown to 655,000 workers last year. But that is a tiny sliver of the total retailing

workforce. Retailing workers might switch to the companies that are taking over empty stores, including restaurants, beauty salons and health clinics. But it is as improbable that such firms will replace all of America's boarded-up shops as that they will offer jobs to every former shop worker, particularly those without training.



Checking out for good

Bye-bye buy, buy

Nowhere has escaped these changes. Even in Manhattan, rents have fallen in some trendy shopping areas. But the shifts will be uneven. Mr Busch of Green Street notes that malls and other stores in areas with wealthy, educated residents will perform better. More vulnerable are places where the supply of shops overwhelms demand. Since 2000 the construction of strip malls has increased even as the population has declined in several rustbelt cities, including Cleveland, Detroit and Pittsburgh. Just as many factory workers in those cities had to find new jobs, so too will shop workers.

Take Saginaw, an old industrial city in Michigan that has seen its population ebb. It has the country's sixth-highest concentration of retailing workers. That may change. A publicly traded REIT called CBL recently sold Saginaw's Fashion Square Mall to a private buyer. Morningstar Credit Ratings thinks the mall's loan is likely to default when it matures in 2022. Alder Hill, a hedge fund that has bet against mall loans, calls Fashion Square a "melting ice cube that will likely be run to maximise cashflow" before its owner walks away.

This slow melt has so far attracted little attention from politicians, despite jobs in retailing outnumbering those in coal mining, which has caught the political eye, by a factor of 300. The most substantial policy idea that will affect retailing will probably not become law. That's just as well. Congressional Republicans' tax plans include a border-adjustment tax, which retailers say would raise the price of imports, thereby crunching margins or forcing price increases. Any other intervention seems unlikely. Americans, so used to visiting shops packed with enticing goods, may have to get used to many more empty ones.

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