Original Article

Management of Indian shopping malls: Impact of the pattern of financing

Received (in revised form): 2nd October 2009

Harvinder Singh
is an assistant professor in Marketing and Retail Management at Birla Institute of Management Technology, Greater Noida. He completed his MPhil in measurement of Retail Service Quality. He submitted his doctoral thesis at Birla Institute of Technology (BIT), Mesra, Ranchi on the topic '*Management of Shopping Malls: Improving the Total Shopping Experience*'.

Swapan Kumar Bose
is Professor and Head of the Department of Management at BIT, Mesra, Ranchi. He is also the editor of the journal *The Alternative*, published by his department.

Vinita Sahay
is Professor of Marketing at Institute of Management Technology, Ghaziabad. Her area of expertise is Services Marketing.

ABSTRACT Shopping malls are fast becoming a central part of life in urban India. Demand projections for mall space in India are lucrative; however, the growth of malls in India over the last decade has suffered from issues such as the high cost of real estate and construction, poor infrastructure, a non-conducive policy framework, and the unavailability of professional expertise in mall development and management. This has resulted in undifferentiated malls, plummeting occupancy levels, and reduced profitability for tenants and malls. Most of these evils have their genesis in the inappropriate pattern of financing used by Indian mall developers. In the Indian scenario, funds for mall projects come from different sources and in different varieties. Funds are raised by selling the mall space to investors and speculators for quick recovery and rotation of funds. The mall is owned in a piecemeal manner by a number of stakeholders. Consequently many problems creep in. These include short-term orientation, distortions in zoning, disturbance of the overall concept of the mall and developer disinterest in promoting malls. All these vices convert the mall into just another 'shopping complex'. To overcome this pattern, lessons ought to be learnt from the United States and other Western countries, where a healthy and steady inflow of pubic funds has kept the malls competitive. Major changes are needed in the Indian mall business in terms of a regulator for real estate, more inflow of public funds and increased transparency, so that this sector prospers in future.

Journal of Retail & Leisure Property (2010) **9,** 55–64.
doi:10.1057/rlp.2009.22

Correspondence:
Harvinder Singh
Birla Institute of Management Technology, Plot No. 5, Knowledge Park II, Greater Noida (NCR), Uttar Pradesh 201 306, India
E-mail: h.singh@bimtech.ac.in

© 2010 Macmillan Publishers Ltd.

Keywords: shopping mall; financing; capitalization; selling of mall space; tenant mix

INTRODUCTION

India is a late starter in the development of shopping malls. The first Indian shopping mall (Spencer Plaza, Chennai) was built in 1990; however, the real impetus came in 1999, when two more malls (Ansal Plaza in Delhi and Crossroads in Mumbai) became operational. During the last decade, there has been a sudden increase in the availability of mall space in India. From just three malls in 1999, the country at present has nearly 200 operational malls providing nearly 87 million square feet of mall space (Images Research, 2007). The year 2007 saw mall development growing at a rate of 76 per cent. For 2008, growth was expected to be around 85 per cent; however, this was dampened by the economic recession. India is expected to have 205 million square feet of mall space by 2010, and a total of nearly 750 operational malls providing 350 million square feet of mall space by 2015 (Taneja, 2007).

Although the concept of shopping malls originated in Western countries, malls located in other countries around the world cannot merely reflect a foreign business system. These malls have to be very specific in their appeal by developing a tenant mix that reflects the needs of target customers, local real estate demand and quality of competition. For instance, Indian malls are not exact replicas of Western malls, as they are customized for specific cultures and localities. They are smaller than their American counterparts, with commercial space for offices as well. Indian malls are located within high-density urban areas, in contrast to the peripheral locations of US malls. Hence, Indian malls are more ‘vertical’ (Singh and Bose, 2008).

DEMAND FOR MALL SPACE: FUTURE POTENTIAL

The Indian retail revolution is being led primarily by young, new, affluent shoppers who want to obtain an ultimate experience while carrying out their shopping. The existing retail scenario does not provide quality retail space to support this, and there is an urgent need for investment in building quality retail and mall space (Singhal, 2007). Traditionally, residential housing was the dominant segment of real estate development in India. However, with the emergence of commercial office space, retail and hospitality, substantial opportunities have been created in the non-residential segments. The non-residential segment is predicted to occupy 26 per cent of the overall market share in 2010 as compared to the 16.7 per cent held in 2005 (Mehta, 2007).

Convinced of the promise and potential inherent in retail, Indian corporate houses are upbeat about this sector, and their future investments are pegged at nearly Rs 5 trillion. Reliance Retail alone is investing Rs 300 billion in setting up multiple retail formats backed by a strong distribution network. (Singhal, 2007). In short, India is expected to achieve in 10 years what took 25–30 years in other major markets in the world. An additional investment of Rs 5 trillion would require approximately 600–700 million square feet of additional retail space

by 2011. Current projections on construction do not exceed 200 million square feet, leaving a gap of almost 400–500 million square feet. To meet this gap, investments are required to the tune of US$ 10–15 billion, and additional investment of $8–10 billion is needed in retail fit-outs and related equipment (Puri, 2007). However, such huge investments in development of quality retail space would take break-even to levels that seem high during the initial phase of retail growth.

TEETHING TROUBLES FOR INDIAN MALLS

The decade-old history of shopping malls in India has been fairly eventful. Despite initial euphoria among the masses and developers, malls have suffered from issues such as availability and cost of quality real estate, spiraling construction cost, poor infrastructure, non-conducive policy framework, and unavailability of professional expertise in mall development and management. This resulted in clustering of almost identical shopping malls. Lack of concept planning and zoning is another serious issue. All kinds of tenants are accommodated at all possible locations inside the mall. Such poorly planned and executed malls fail to ensure 100 per cent occupancy at the time of commencement of operations, or see plummeting level of occupancy because of non-renewal of lease by existing tenants (Tiwari, 2008). Despite this, mall developers are keen on having as many tenants as possible as soon as possible. Traffic, infrastructure and ecological issues come to the fore only after the situation becomes intolerable and unmanageable (Taneja, 2005). However, most of these evils have their roots in the way shopping malls are financed in India.

SOURCES OF FINANCE FOR INDIAN MALLS

The Indian real estate sector has seen tremendous growth in recent years, with property prices soaring and the number and scale of projects increasing. Developers have been looking at new sources of raising funds. However, Indian real estate business is very conventional. All major real estate firms are either closely held or have moved toward the public ownership model only very recently. Investments flowing into this sector have primarily been arranged by either the developer as his contribution (seed capital) coming from different sources and in different varieties. Over recent years, funding has started coming from other sources, which is a step toward maturity in outlook and approach for this sector. Sources of finance for this sector may be categorized into the two broad areas of private and public funds.

1. Private funds

Contributions from promoters may come as private debt or private equity. Sixty per cent of financing in Indian projects comes from capital contributed by the promoters from their personal kitty along with debt taken from financial institutions (private debt) (Yadav and Mahajan, 2006). Statistics available for the past 5 years indicate that bank loans for commercial real estate increased by more than 500 per cent between 2001 and 2006. However, financing real estate development has never been popular, because of perceived opaqueness of pricing in the market,

lack of clarity and standardized practices, and associated risk of what is still seen as a speculative bubble (Srinivas, 2008). The situation became severe last year owing to the economic recession, and banks have ceased lending.

Nearly 40 per cent of the requirement is met by private equity. Broad-based private equity participation in the real estate sector is constrained primarily because of regulatory impediments. In 2005, Securities and Exchange Board of India (SEBI) took a positive step by approving the formation of Real Estate Funds (REFs). Expected entry of real estate mutual funds (REMFs) would herald a new era and avenues for commercial retail investors in the real estate sector. At present, REFs are only open to High Net-worth Individuals, institutional investors and global investors. Although this segment has been growing at a decent pace, its huge potential is still untapped, for example institutions such as pension funds and insurance agencies.

2. Public funds

Public funds may be routed to these projects through two channels: public debt and public equity. The public debt market in India, which comprises Commercial Mortgage Backed Securities and corporate bonds, is still in its nascent stage, as can be seen by Indian structured securitization products such as Residential Mortgage Backed Securities, which have just begun operations. The contribution of public equity is also insignificant. Public equity may come through Initial Public Offers (IPOs) in the stock market, Real Estate Investment Trusts (REITs) or REMFs. Keeping in view the tremendous bull-run in the stock markets between 2005 and 2007, a number of players, such as DLF, Omaxe and Parsvanath, planned their IPOs in the past. In fact, in 2006, real estate IPOs were the second-largest mobilizers of funds from the stock markets (Rs. 3993 crore), second only to energy companies. But the sudden crashing of stock markets after Reliance Power IPO in January 2008 has put a damper on development, and market observers are a bit skeptical. Although not possible at present, there is an urgent need to open REITs and REMFs to public equity, as this will improve transparency and liquidity in the real estate capital market.

GLOBAL PATTERN OF MALL FINANCING AND MANAGEMENT

In developed economies, shopping malls are financed primarily by public funds and are run by professional mall managers. Mall managers plan the product mix, monitor traffic, organize promotional programs/events and manage day-to-day affairs. All this requires a high degree of control over the development. Therefore, space within the mall is not sold like office or residential space (Wang, 2005). Investment for the mall project comes primarily from the public; hence, there is no pressure for immediate recovery. Such is the extent of penetration of public finances that 90 per cent of the US malls are owned by institutional investors such as Investment Trusts (Wang, 2005; Singh and Bose, 2008). Retail space within the mall is offered to tenants (brands) on agreed-upon rents.

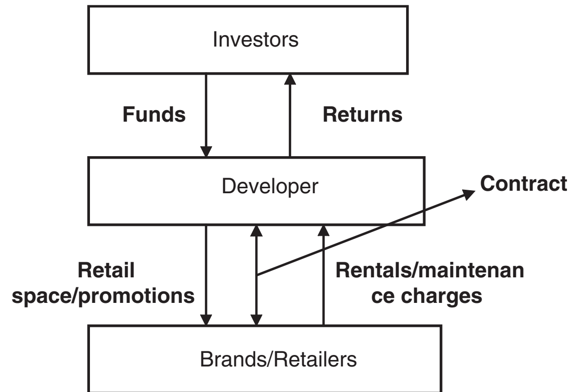

Figure 1: Standard Model of Mall Management.

This pattern of financing results in a management whereby ownership of the mall remains with one entity (the developer) and investment is recovered over a longer period of time (10–20 years) by way of rental leases. Tenants have a direct contractual relationship with the developer who collects rents, and investors receive returns in the form of dividends throughout the life of the project (Figure 1).

MALL FINANCING AND MANAGEMENT: THE INDIAN SCENARIO

India has its own model of mall financing. Funds invested in Indian mall projects come from different sources in different varieties. The Indian model of financing is characterized by selling of mall space, rotation of funds and piece-meal ownership of the mall by different stakeholders. Mall projects are sold to recover the investments, and returns are invested in the next project. This tendency also has its roots in economic characteristics such as interest rates and capital availability. Developed countries with low interest rates and easy availability of capital are different from countries such as India where rate of capital formation is low and demand for capital from different sectors of the economy is tremendous, which pushes interest rates to higher levels. This makes investors impatient for the immediate recover of their money. Rotation of capital among different projects becomes a vital parameter for overall profitability over a period of time.

Indian mall projects receive funds from the following sources:

1. Private creditors who extend loans to developers in expectation of interest.
2. Investors who buy mall space in expectation of rents promised or guaranteed by the mall developer.
3. Speculators who book or purchase mall space in expectation of reselling it for profit.

In India, most mall developments are pre-marketed (capitalized) on paper before the groundbreaking takes place. This way, the developer obtains funds for construction of the project instead of taking loans from banks at

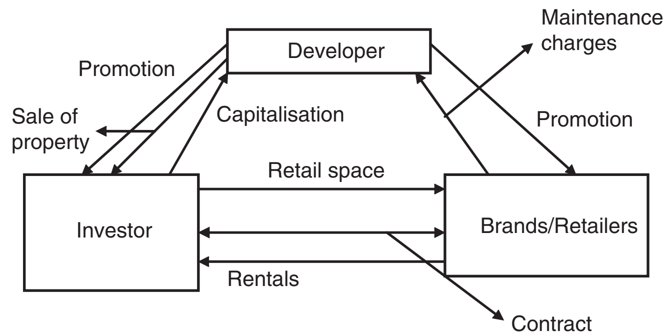

Figure 2: Indian Model of Mall Management.

a higher rate of interest. Bank loans are available at interest rates ranging between 14 and 18 per cent, but even these are hard to come by, as banks are becoming reluctant to lend because the property market is cooling (Hussain, 2008). The mall project is completed and tenants are roped in to open retail outlets in the mall. Some of them may actually buy retail space. Although the tenants are contacted and convinced by the developer's marketing team, the actual lease contract is signed between the tenant and the investor/speculator, who is the legal owner of that piece of mall space. Whereas the investor recovers his investment over a longer period of time by receiving rents, speculators try to make the kill by selling the mall space to some other investor or tenant at remunerative prices. Private creditors obtain their interest and capital refund from sale proceeds of the mall space. After settling the liabilities, the developer is left with the surplus (his share of the profit), which he may reinvest in future projects.

Effectively, such ownership and financing structures mean that most malls are owned by neither the developer nor the retailer, but piecemeal by a range of stakeholders. This results in unplanned and uncontrolled development of the mall and eventual loss of rental values (Figure 2).

This issue becomes more complicated owing to lack of understanding of the retail market among investors and developers. Only a fraction of Indian malls follow the lease model currently, while globally most malls are only on lease (*The Financial Express*, 2006).

PROBLEMS DUE TO CAPITALIZATION

Capitalization sounds the death knell of a mall, as it results in fragmented ownership. Selling a mall to individuals is like selling a cake in several pieces, thereby eliminating the very existence of the cake itself. A mall working on such a financing and management model faces the following problems:

1. *Short-term focus on immediate profitability*: After arranging finances from private sources, the mall developer is under pressure for immediate and profitable recovery. This compels him to adopt a selling approach. He is more inclined toward exiting the project early by selling retail mall space to investors and book profits. In a bid to maximize his returns, he indulges in deliberate overvaluation of the

project and capitalizes on it at a higher rate. Depending on negotiations, different investors may be charged different rates of capitalization for similar mall space. This creeps into tenancy as well, when different tenants may end up paying different rents for similar space in the mall (Tiwari, 2008).

2. *Disturbing the overall planning and concept of the mall*: In their hurry to sell space and recover investments, mall developers lease out retail space on a first-come-first-served basis. This creates a sub-optimal tenant mix, for example a food and beverage outlet next to a designer apparel shop instead of an accessories or a footwear shop (Roy and Masih, 2007). During the later stages of mall life cycle, some of the tenants may refuse to renew their lease agreement after the expiry of the initial agreement. In such cases, the developers accommodate tenants that are not appropriate for that space so as to keep the space occupied. Sometimes developer divides the project into a large number of very small retail units so as to ensure quick and remunerative disposal of space. These spaces are readily accepted by speculators and investors, but the presence of small spaces is detrimental for a mall (Hussain, 2008). Such allocations disturb the overall planning and concept of the mall.
3. *Improper facilities management and maintenance*: Once the developer recovers his initial investment by way of capitalization and moves on to newer projects, his interest in the older mall tends to diminish. The situation becomes exacerbated by the fact that rents (the major part of the revenue) go to the investor, whereas the developer has to run the show with Common Area Maintenance (CAM) charges. If the developer attempts to profit from CAM charges, facilities management and maintenance operations in the mall are badly hit. As the ownership of individual retail spaces ends up being with different entities, there is no central authority managing the malls; there is no control over the various facets of mall management (Roy and Masih, 2007).
4. *Developer disinterest in promoting the mall*: Once the stores are leased out, developers are less interested in promoting the mall. However, malls need to organize promotional events that are well spread out and customized keeping the clientele in mind. Moreover, the need for promotion increases with the age of mall. Once the novelty of a shopping mall wears off, there is an intense need to engage customers in promotional activities. Most developers do nothing about the branding, marketing and promotion aspects of running a mall (Jain and Ullathil, 2003; Bhupta, 2005).

THE WAY AHEAD FOR INDIAN MALLS

Because the cost of land is a major component of total project cost, the majority of Indian mall developers also happen to be real estate developers. The Indian real estate market is plagued by problems such as high undervaluation on paper, speculative nature, influx of 'black' money and dominance of non-transparent transactions. The Indian mall business has developed peculiarities that distinguish it from the way this business

is done across the globe. A large number of these peculiarities arise owing to a unique financing pattern as discussed in previous sections. The following changes are suggested in current policies and practices so that Indian malls can flourish:

1. *Infuse public money in real estate*: The injection of public money is mandatory to improve the performance of the real estate sector, as developers would then be in a position to plan on a long-term basis because there would be no pressure for immediate recovery of investment. Inflow of public money would require developers to maintain some standards of governance, as they would be answerable to a larger and varied set of stakeholders. The government would also play a role in safeguarding public investments, while statutory authorities such as the Securities and Exchange Board of India (SEBI) would keep developers on their toes.
2. *Establish REIT/REMF*: An REIT is a company that buys, develops, manages and sells real estate assets, and allows participants to invest in a professionally managed portfolio of properties. REITs would serve as an effective vehicle for broader participation by investors in the market. Entry of REITs would extend clear-cut advantages such as a high degree of liquidity, lowering of the threshold level of investment in real estate, and greater transparency and fairness in management (Patil, 2008; SEBI, 2008). Similar advantages would ensue from the entry of REMFs. Such a mutual fund invests directly or indirectly in real estate property, and is governed by the provisions and guidelines under the SEBI (Mutual Funds) Regulations, 1996 (Srinivasan, 2007).
3. *Attract foreign funds*: Through its policy drafts in 2002 and 2005, the Committee on Economic Affairs decided to permit 100 per cent FDI in the form of housing, hotels, resorts, commercial premises, educational institutions, recreational facilities, hospitals, and city- and regional-level infrastructure in order to attract higher investments. Earlier, restrictive norms were imposed on foreign investments, with their presence permitted only in the integrated townships (Taneja, 2007; Singh and Singh, 2009).

   In recent years, global real estate securities funds have been seeking real estate investment opportunities in the emerging real estate markets, particularly in Asia. This investor interest sparked the establishment of over 59 global real estate securities funds with over $14 billion in assets under management. Importantly, Asia accounts for 27.5 per cent of these fund assets under management (Newell and Kamikeni, 2007). With an estimated $79 billion in investment-grade real state, India accounts for 0.5 per cent of the world's investable real estate, and is the sixth largest real estate market in Asia after Japan (13.5 per cent), China/Hong Kong (1.9 per cent), South Korea (1.6 per cent), Taiwan (0.8 per cent) and Singapore (0.6 per cent) (Newell and Kamikeni, 2007).
4. *Ensure transparency*: To ensure investor confidence, both domestic and overseas, there is an urgent need to improve transparency in real estate transaction in India. Despite considerable opacity at present, the

 © 2010 Macmillan Publishers Ltd. 1479–1110

Indian real estate market is showing signs of improvement on this parameter. The Jones Lang LaSelle Global Real Estate Transparency Index, 2008 placed India in the 'Semi-Transparent' category along with China and South Korea, up from 'Low Transparency' category in 2004 index (Datamonitor, 2006, 2008). In fact, the Indian real estate market has shown consistent improvement in this index over the past few years.

5. *Establish a regulator for real estate*: The real estate sector needs a proactive regulatory along the lines of the Telecom Regulatory Authority of India. To be effective, the regulator would be required to work on multiple fronts. On the policy front, it may ensure enactment of regulations for this sector; on the performance front, it may set standards and benchmarks to be followed by different players in this sector; on the information front, it may ask for statutory information and latest developments from different players and share them with stakeholders; on the supervision front, it may keep an eye on violation of norms by different players; and on the adjudication front, it may receive customer complaints and process them on a fast-track basis to come up with verdicts.
6. *Adopt a standard model of mall management and partnership*: It is important that Indian malls are managed in accordance with international mall management practices, and a vital component in this regard is ownership of malls by developers. Developers need to recover capital investment in the long term by way of collecting rents directly from the tenants. It is heartening to see that more and more developers are moving toward adoption of this standard model of mall management with the passing of time. This is significant, as malls are the most wealth-generating property medium. Thus, rather than selling the mall, the developer should retain its ownership (Grossman, 2005). There is a need on the part of developer to view stores as partners and not merely rent-paying tenants. Creating this partnership would require constant consultation and tremendous trust. In a case in which it is imperative to sell the property, damage may be minimized by imposing strict conditions for permitted uses. The developer may retain the right to lease it out to tenants of their choice. The investor would legally be the owner of the property, but the developer would decide on the tenant. The investor, however, would have the right to sell the property (Hussain, 2008).
7. *Promote revenue-sharing model*: A common practice in developed markets is the use of the revenue-sharing model in determining rent. Under this arrangement, the tenant either pays a fixed monthly base rent as minimum guarantee and/or a 'percentage of sales' rent. This is beneficial for both landlords and retailers, as landlords are encouraged to organize promotional activities that would increase retailers' revenues because they get a percentage share in it. This model works successfully in both bullish and bearish market conditions. When the market is weak, retailers are protected from rising rental costs (Roy and Masih, 2007). This method develops a bond between developer and tenant, as the revenue of the developer is linked to the turnover of their tenants.

CONCLUSION

India is still in the growth stage of the mall lifecycle, and if mistakes committed during this phase are taken as lessons and guiding principles for charting a future course of action, the future of shopping malls could indeed be bright. To accomplish this, a concerted effort is needed by developers as well as government. There is an urgent need to make the retail real estate sector more transparent, accountable and customer-oriented. Only then will the growth of shopping malls in India be truly sustainable.

REFERENCES

Bhupta, M. (2005) Mall mania. *India Today* 21 November: 17–18.

Datamonitor. (2006) Real Estate Management & Development in Asia-Pacific: Industry Profile. London, UK: Datamonitor Group, Report Reference Code 0200–2132.

Datamonitor. (2008) Global Real Estate Investment Trusts. London, UK: Datamonitor Group, Report Reference Code 0199–2131.

Grossman, C. (2005) Inaugural address. 2nd annual ICSC-India Shopping Centre and Retail Conference; 29–30 August, Mumbai.

Hussain, S. (2008) Cash-strapped developers look to buyers to fund construction. *The Mint* 27 May: 7.

Images F. & R. Research Analysis. (2007) Mall space in India: A demand and supply analysis. In: A. Taneja (ed.) *Malls in India: Shopping Centre Developers and Developments*. New Delhi, India: Images Multimedia, pp. 150–155.

Jain, S. and Ullathil, P. (2003) Its all about footfalls & conversions. 17 October, http://www.rediff.com/money/2003/oct/17malls.htm, accessed 8 April 2009.

Mehta, R. (2007) A study on the Indian real estate market for investment: A qualitative approach. MA (Finance & Investment) dissertation, University of Nottingham, UK.

Newell, G. and Kamikeni, R. (2007) The significance and performance of Real Estate Markets in India. *Journal of Real Estate Portfolio Management* 13(2): 161–172.

Patil, S. (2008) The draft real estate investment trusts Regulations, 2008 – A critique, http://www.Indialaw.com, accessed 14 May 2009.

Puri, A. (2007) Designing India's mall potential. In: A. Taneja (ed.) *Malls in India: Shopping Centre Developers and Developments*. New Delhi: Images Multimedia, pp. 72–75.

Roy, D. and Masih, N. (2007) Mall Management: A Growing Phenomenon in Indian Retail Industry. New Delhi, India: Report by Jones Land LaSelle Meghraj.

Securities and Exchange Board of India. (2008) Draft Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2008. Mumbai, India: circulated for public comments by Securities and Exchange Board of India.

Singh, H. and Bose, S.K. (2008) My American cousin: Comparison between Indian and the US shopping Malls. *Journal of Asia-Pacific Business* 9(4): 358–372.

Singh, V. and Singh, K. (2009) Prospects & problems of real estate in India. *International Research Journal of Finance and Economics* 24: 242–254.

Singhal, A. (2007) Consumer demographics and changing consumption demands innovation in upcoming mall projects. In: A. Taneja (ed.) *Malls in India: Shopping Centre Developers and Developments*. New Delhi: Images Multimedia, pp. 54–60.

Srinivas, S. (2008) Capital ideas: Realty check. *Business World* February: 33–34.

Srinivasan, G. (2007) Real estate mutual fund keenly awaited. December: 12.

Taneja, A. (2005) Keynote address. 2nd annual ICSC-India Shopping Center and Retail Conference; 29–30 August, Mumbai.

Taneja, A. (ed.) (2007) *Malls in India: Shopping Centre Developers & Developments*. New Delhi: Images Multimedia.

The Financial Express. (2006) Mall developers prefer lease management. 31 October, http://www.financialexpress.com/news/mall-developers-prefer-lease-management/182310/2, accessed 14 June 2009.

Tiwari, M. (2008) Big brands plan to pull out of malls. *The Economic Times* 21 September: 6.

Wang, Q. (2005, April) Economies of scale in shopping centre industry. Master of Science Thesis, Royal Institute of Technology, Stockholm, Sweden, 291, April.

Yadav, B. and Mahajan, S. (2006) *Indian Real Estate*, Hyderabad, India: Report for Karvy Stock Broking Limited.