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Morris A. Ellison

E-Commerce's Impact on Small Business in the Age of COVID-19

Since March 2020, the COVID-19 pandemic has impacted virtually all aspects of our daily lives. Zoom meetings have replaced conference room gatherings. Kids attend classes from kitchen tables. Family movie nights are likely to involve a first-run film streamed to a television, not a trip to the local cinema.

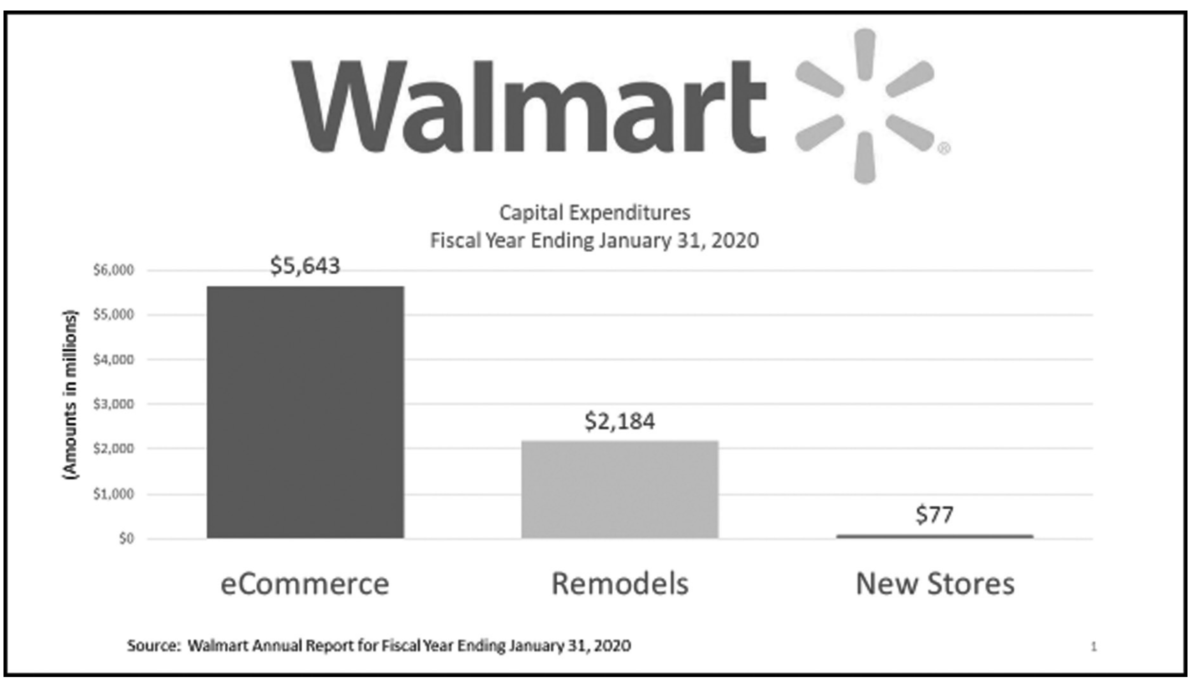
The retail sector certainly has felt the upheaval of the pandemic. But despite what some may think, not all of the news is bad. Retailers have found new ways to connect with, and serve, customers, particularly through e-commerce. Retail sales numbers for Q3 and Q4 2020 prove that customers are willing to spend both online and in stores—but their expectations for the shopping experience have changed.

In order to keep pace with this new reality of retail shopping (which isn't going to revert back to pre-pandemic norms even after COVID-19 is in check), retailers must focus on maximizing the in-store experience for customers, strengthening online retail offerings and being mindful of rising costs related to operating a brick-and-mortar store.

Retail Trends Show Massive Online Growth, Positive Signs for In-Person Sales

To be clear, e-commerce was here to stay long before COVID-19 entered our collective vocabulary. Statistics show a relatively steady increase of e-commerce's share of retails sales from 2011 through 2019. Internet Retailer magazine estimated that in 2019, online sales made up 16 percent of total retail sales, up from 7.6 percent in 2013.[1] Department of Commerce numbers, while differing somewhat, show a similar trend. The increase remained relatively steady even in 2018–2019 after the United States Supreme Court ruled that state and local governments could force online retailers to collect sales taxes.

Even pre-pandemic, Wal-Mart clearly saw the trend to e-commerce accelerating. For its fiscal year ending January 31, 2020, Wal-Mart invested $5.6 billion



in e-commerce while investing a relatively meager $2.1 billion in remodeling existing bricks and mortar stores and an even skimpier $77 million in new stores.[2]

Enter the pandemic which fully hit in March 2020, accelerating this trend into overdrive. E-commerce sales volume reached $211.5 billion in Q2 2020, growing 32 percent from Q1 and 44.5 percent year-over-year. Significantly, e-commerce sales declined from Q2's high to $209.2 billion and declined again in Q4 to $206.6 billion perhaps as concern with COVID-19 seemed to abate somewhat during the holiday season. Still, Q4's online growth was the second-highest ever rate for the quarter and nearly double the 16.3% growth registered in 2019.[3]

In 2020, the estimate is that $1 in every $5 spent on retail purchases came from online orders. Moreover, these numbers don't include transactions that were "touched" by online—such as a customer researching a product online and buying it at a store.

But the growth in e-commerce retail sales hasn't come entirely at the expense of brick-and-mortar retail. In fact, Commerce Department data reports that in-store retail reached an all-time quarterly high of $1.259 trillion in Q3 2020, rebounding 14.5% after a shaky Q2. Total retail sales reached $4.04 trillion in 2020, up from $3.78 trillion in 2019, according to a Digital Commerce 360 analysis of Commerce Department data, with e-commerce accounting for nearly three-quarters of the total gains.

Online retail still doesn't completely satisfy most consumers, though. A 2018 study reported 90% of surveyed shoppers stated high shipping fees and home delivery lasting more than two days would deter an online purchase.

Customers still want the immediacy and in-person experience of physical retail shops. However, they want to engage with these shops in a different way, and that involves a blended approach that combines aspects of online and in-person retail. Small business must adapt to survive.

Blended Approach Critical in Evolving Retail Economy

No doubt, online retail has played a huge role in keeping the U.S. economy from suffering even greater damage during the pandemic. Stay-at-home orders and consumer concerns about exposure to the virus led people to order goods online and have them shipped to their homes with increased frequency.

Amazon (the nation's #2 retailer behind only Wal-Mart but responsible for nearly half of all e-commerce gains in 2020) cracked the code with its Prime service, offering free shipping and two-day (or faster) turnaround. Not surprisingly, Amazon saw tremendous sales growth in 2020. Other national retailers, including Wal-Mart (cited above) and Target, have poured resources into strengthening their online shipping services even before the pandemic.

Omni-channel marketing—which combines the strengths of online and in-person retail—offers opportunities for brick-and-mortar retailers to serve customers in this new environment of increased comfort with web shopping. For example, customers shop for items online, then pick up their merchandise either in the store or, even more conveniently, curbside in their cars.

The market shift in retail poses tremendous challenges to small retailers, challenges that COVID-19 accelerated but did not create. Omni-channel marketing is difficult for small retailers due to the costs associated with setting up such an operation. Engaging in e-commerce is more than simply setting up a website and waiting for orders. Such costs include:

- E-commerce software. Retailers must either set up their own system for online purchases or pay a third-party vendor (such as Shopify) to help process orders.
- Sales tax accounting. Large, national retailers have the resources to sort out tax obligations on a state-by-state basis. But small businesses likely need to employ third-party software options to track state sales taxes.
- Search engine optimization (SEO). Businesses need to be able to get customers' attention on Internet searches for key terms, and getting this coveted placement costs money.

Black Friday/ Cyber Monday Demonstrate Omni-Channel Marketing's Growing Potential

2020's Black Friday and Cyber Monday—typically two of the busiest sales dates of the year—illustrate how rapidly the retail market is shifting.

Black Friday foot traffic to physical stores decreased by 48 percent. However, spending per customer increased by more than 36 percent.[4] Black Friday online sales were up 22 percent from 2019 to $9 billion, while Cyber Monday sales were up to $10.2 billion—a 15 percent increase year-over-year.[5] These numbers reveal several things:

- Customers still are willing to spend money, even in the current economic downturn;
- Shoppers are generally more purposeful; they come to stores knowing what they want to buy; and
- Consumers still place value on in-store purchases but increasingly need a reason to visit the store.

Another key statistic worth noting is that contactless curbside pick-ups at retail stores were up a whopping 52 percent on Black Friday 2020. This increase recognizes consumers' desire for safety during the pandemic, as well as their desire for immediate access to retail products.

The BOPIS (Buy Online Pickup in Store) revolution blends online and in-store customer engagement, providing consumers with a more convenient way to shop. Again, it is likely customers will continue to crave that convenience even after the pandemic is over.

Legal and Business Challenges Facing Brick-and-Mortar Retailers

But BOPIS and the changes wrought by COVID-19 raise significant business and legal issues. For example, if an anchor store leaves, other retailers in the shopping center may be able to trigger lower rent or even lease termination rights. Also, if rent is based on a percentage of retail sales, are BOPIS sales included in that total and, if so, how?

Shopping center owners may wish to repurpose vacant retail space to uses such as medical offices. With the move to work from home (WFH), some small businesses have been particularly hard hit. Think about restaurants and small retailers located in expensive downtown locations where offices remain largely vacant. Leases often contain roadblocks to reinvention and should be reviewed by landlords and tenants to address issues such as parking, hours of operation and use restrictions.

Applicable restrictive covenants may limit repurposing malls and big box stores as delivery points. Also, restrictive covenants may limit rights to use common space for deliveries to consumers. These issues should be addressed up front, as it is in the best interests of both retailer and retail landlord to keep customers satisfied.

Many brick-and-mortar retailer costs are fixed and don't depend on foot traffic or sales. These fixed costs include such items as base rent, insurance, enterprise software (needed to run the business, manage payroll, etc.), common area maintenance (CAM), and ad valorem property taxes. COVID-19 hasn't decreased these costs.

Ad valorem property taxes can be particularly problematic. These taxes typically are based on a store's rent, not its profitability. Unfortunately for most retailers, current property tax bills are often based on valuation dates which predate the pandemic and therefore are irrelevant for current property tax bills. Some jurisdictions apply these valuation dates for years thereby further oppressing small business whose sales have been hit hard by COVID-19.

COVID-19's impact on local and municipal budgets is being hotly debated. Prior to November 2020, municipal revenues had declined 21 percent during the pandemic, while municipal expenses increased 17 percent.[6] It doesn't take an economist to realize those two trend lines are unsustainable for city budgets and likely will mean deep cuts in municipal services, significant increases in property taxes—or both. And generally, only property owners, not tenants, may challenge property tax valuations. The American Recovery Act of 2021 (the "American Rescue Plan") passed in March 2021 may lessen these burdens on local government, but commercial properties remain a tempting target for local government looking to solve their budgetary issues. It is vital that retail property owners and their tenants work together to resolve these challenges.

Key Considerations for Retail in the COVID-19 Era

Retail trends continue to evolve, but the country's embrace of e-commerce seems permanent. It was certainly trending in this direction even before the pandemic. So retailers need to prepare to meet customer demand, both now and in the post-pandemic future. Some items to consider:

1. Create value in the in-store experience. Customers aren't ready to give up in-person retail, but stores must give them incentives to shop. Keep

in mind that today's customer values convenience.

2. Omni-channel marketing is here to stay. So look for ways to marry online and in-store offerings. The aforementioned BOPIS model, for example, combines the convenience of e-commerce with the immediacy of in-store shopping.
3. Pay attention to lease provisions. In particular, keep a close eye on BOPIS rights, rent considerations (*i.e.*, are there thresholds for triggering automatic rent reductions/lease escapes?), use restrictions, hourly operating requirements and taxes.
4. Seek to reduce occupancy costs inherent in bricks and mortar retail (*e.g.*, ad valorem taxes). The good news for retailers is that we are in a buyer's market for commercial real estate space. Stores should work with their landlords on ways to reduce the fixed costs of doing business.[7]

Morris Ellison is a partner with the law firm of Womble Bond Dickinson (US) LLP. A prolific author on topics such as mobility, ecommerce, real estate development, property tax issues and receiverships, Morris is a fellow in both the American College of Real Estate Lawyers and the American College of Mortgage Attorneys. He is the South Carolina member of the American Property Tax Counsel and a panelist for the CPR Panels of Distinguished Neutrals. He has been awarded the CRE® (Counselor of Real Estate) credential by The Counselors of Real Estate.® He may be reached at morris.ellison@wbd-us.com.

1. *Internet Retailer* magazine.
2. Wal-Mart annual report for fiscal year ending January 31, 2020.
3. *https://www.digitalcommerce360.com/article/quarterly-online-sales/ Digital Commerce 360* (February 19, 2021).
4. RetailNext.
5. Adobe Analytics.
6. National League of Cities.
7. For more from Morris Ellison on the impact of the COVID-19 pandemic on the retail and real estate sectors, please see the following articles: "Expect Increased Property Taxes: Commercial property owners are a tempting scapegoat for cash-strapped governments in the wake of COVID-19," in *Commercial Property Executive*, and "Reduce High Occupancy Costs," in *Heartland Real Estate Business* and *Southeast Real Estate Business*.