Simon Property Group, Inc.

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A. Executive Summary

Shopping malls which were the town halls for most urban and suburban areas are now becoming obsolete. They were the places which provided family bonding, a multi shopping point, a hangout spot for teens and even grown-ups. But today, this traditional set up of shopping malls is under great threat.

Technology is playing a vital role in every spectrum of people's lives, and it is changing how we think, live, shop, eat and spend quality time with our dear ones. This change in lifestyle has made shopping malls less attractive than ever before. Real estate developers must adapt to this change in behavior and provide new ways to fulfill the needs of today's people. As consumers adapt digital technology, there is a need to redefine the kind of experience such shopping malls provide.

In this report, we have performed a substantial amount of research on the industry landscape and the different forces supporting the change in the landscape. A brief history of SPG and how they have evolved as the pioneers in the real estate space is provided. With this, we have given details on the important financial dynamics associated with the case. We are also overviewing a general timeline of important events and how the value migration was initiated in the retail space.

We have analyzed the how SPG has adapted to this value migration and what were the key management decisions in driving the business. Certain flaws in the management decisions have been pointed out. The value outflow could have been controlled better with a few visionary approaches. The report touches upon the business model SPG adopts and the various forces that influence that model. We have also identified a few key points in the business model that does not provide value to the customer anymore.

Further in the report, we have identified the jobs to be done for the customers of SPG. We considered the key trends, the market and industry forces, and the macroeconomic forces. A list of recommendations for SPG to propose the desired value to its direct customers and end customers have also been included, that overall focusing on maximizing the customer experience inside the malls and the concept of "microcities" instead of "malls." By providing an experience that cannot be substituted with an online platform or any other means will attract people. People seek for more value in every offering, but the essence is that we are all social beings and would love any space that helps us connect to the society and experience the latest buzz.

B. Value Migration in the Retail Space

Every 50 years, retail industry gets disrupted and thus happens the value migration. A century and fifty years ago, with the rise of railroads and growth of big cities, introduced the concept of departmental stores. In the 1960s and 1970s, the discount stores like Walmart, KMart spread across the US and disrupted the old style malls[1]. In the same decade of 1960, Melvin Simon, later the founder of Simon Property Group, experimented with the concept of the anchor and non-anchor stores in an enclosed shopping plaza. The success of this experiment led to the malls with the idea of charging less to anchor stores and charging more to non-anchor stores.[2] In the late 1990s, the retail industry saw the rise of amazon.com, pets.com which again disrupted the retail and the retailers got a new platform to sell their products.

Physical Retail was the only platform to sell your product or services. But with the rise of desktop and mobile e-commerce, it declined sharply. The decline in physical retail as a platform is visible from the fact that the number of shopping malls in the US are almost constant after 2007, refer to Figure 1[3].

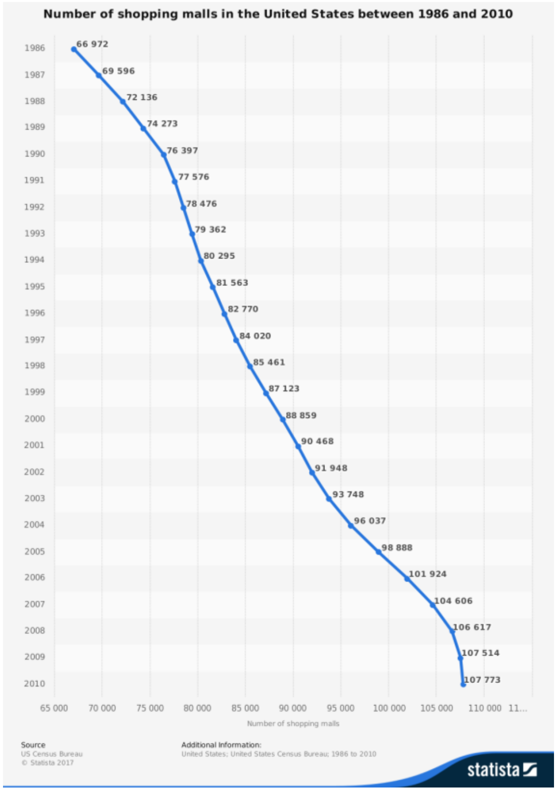

Figure 1: Shopping malls in U.S from 1986 to 2010

Until 2000 the physical retail was in value inflow phase, and there was limited competition from other platforms, high growth, and high profitability. With the invention of other platforms like

[1] "The Future of Shopping - Harvard Business Review." https://hbr.org/2011/12/the-future-of-shopping. Accessed 22 Feb. 2018.

[2] "History of Simon Property Group, Inc. – FundingUniverse." http://www.fundinguniverse.com/company-histories/simon-property-group-inc-history/. Accessed 22 Feb. 2018.

[3] "• Number of shopping malls in the U.S. | Statistic - Statista." https://www.statista.com/statistics/208059/total-shopping-centers-in-the-us/. Accessed 22 Feb. 2018.

desktop e-commerce and mobile e-commerce, the physical retail went to value stability phase with stable market and margins. Currently, physical retail is in value outflow phase with many retailers like Toys R Us, Sears going bankrupt and many stores are getting closed[4]. Some are calling this phase of many stores getting closed as retail apocalypse. While the physical retail is suffering, the e-commerce sales are increasing rapidly, and the e-commerce sales in 2016 were 291 billion, see figure 3[5].

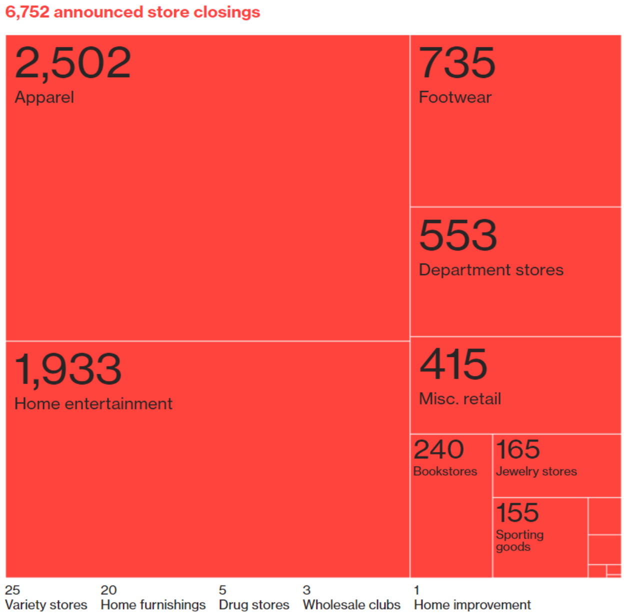

Figure 2: Store Closures in Q1-Q3, 2017

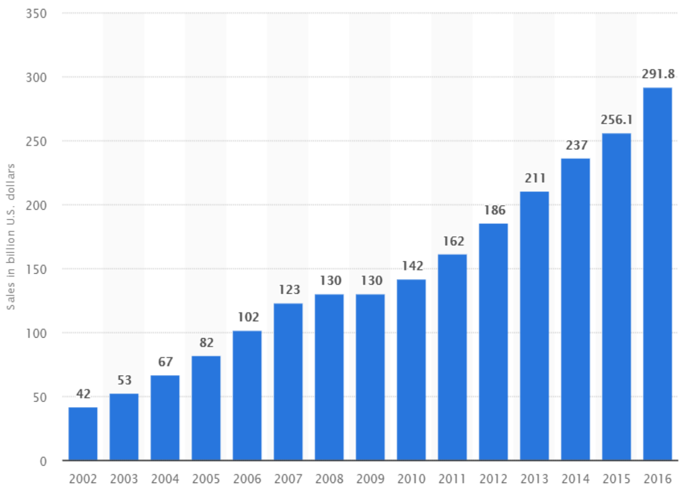

Figure 3: E-commerce sales in the US from 2002-16

However, the physical retail is now in a phase of transformation with many online stores such as Warby Parker are opening their stores to provide an experience that can not be provided online. Physical retail is now viewed as a space to make customer relationships which is called going “high-touch.” The value is getting shifted in physical retail from being a place to drive

[4] "America's 'Retail Apocalypse' Is Really Just Beginning - Bloomberg." 8 Nov. 2017, https://www.bloomberg.com/graphics/2017-retail-debt/. Accessed 22 Feb. 2018.

[5] "• U.S. desktop retail e-commerce sales 2002-2016 | Statistic - Statista." https://www.statista.com/statistics/273424/retail-e-commerce-sales-in-the-united-states/. Accessed 22 Feb. 2018.

transactions to a place where retailers can experiment and can form a relationship with their customer[6].

C. SPG position in the industry

C.1 Timeline of portfolio

Simon Property Group was formed in 1993 as the Melvin Simon & Associates (MSA) company became publicly traded[7]. MSA was one of the leaders in development of shopping centers in the US. Its strategy grew progressively: from small open-air shopping plazas in 1960 then to mixed-use properties, mixing retails with living (apartments, hotels) and office places in 1970-1980, and finally to experience-based shopping malls from 1990. It added entertainment and dining facilities and special designs within the malls, such as the Mall of America project: 4.2 million square foot complex, that provided family theme park, golf course, aquarium, nightclubs… in addition to 500 specialty shops. From then, SPG expanded its portfolio and presence in major metropolitan markets through numerous mergers and acquisitions. It also launched dedicated marketing programs to build brand loyalty both for the vendors and the shoppers.

Today, SPG owns 206 income-producing properties[8] in the US over 37 states and Puerto Rico. It also has an international presence as well in Japan (9 Premium Outlets), South Korea (3), Canada (2), Mexico (1), Malaysia (1), and owns interests in Designer Outlet properties in Europe (6 Designer Outlet properties), in Canada (1), and also in Klepierre, SPG's European twin having interests in shopping centers across 16 European countries. The following diagram depicts the repartition of SPG's portfolio, with more than 182 million square feet of gross leasable area:

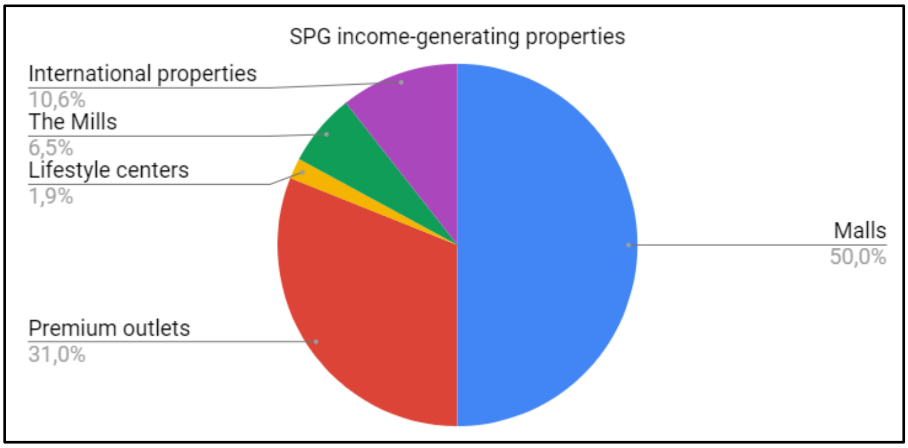

Figure 4: SPG income generating activities

Vocabulary note:

[6] "Toys 'R' Us Might Be Dying, but Physical Retail Isn't." 20 Sep. 2017, https://hbr.org/2017/09/toys-r-us-is-dead-but-physical-retail-isnt. Accessed 22 Feb. 2018.

[7] http://www.fundinguniverse.com/company-histories/simon-property-group-inc-history/

[8] https://www.reuters.com/finance/stocks/company-profile/SPG

- Premium Outlets are designer and manufacturer stores, located near major metropolitan areas and tourist destinations.
- Mills are located in metropolitan areas and offer retailer stores, traditional malls, mixed with entertainment facilities.

Every year, SPG adds 300 new brands to its portfolio, has 3 billion customers, and generates over 60 billion $ of sales. SPG collaborates continuously with partners to innovate the shopping experience of the customers and support, therefore, its retailers[9].

Its current strategy is to increase capital/lease allocation to food services, lifestyle brands and eTailers (normally online-only retailers) who want to set up a physical footprint. eTailers demand is apparently growing and a interesting new market for SPG[10].

C.2 Current financial situation

Despite a strong operational performance and value for excellence[11], the share price graph below shows that today's share price of SPG has dropped 30% off its peak that happened mid-2016[12].

Figure 5: Share price of SPG from 2015 to 2018

The following sections explore different qualitative reasons for such a drop and possible recommendations to the Company concerning future actions to take.

C.3 SPG Value Migration analysis

[9] http://f2d62a308d3c313ac136-fe453cfe00977a743e98d480a2f68fee.r14.cf1.rackcdn.com/Simon-Iconic-Properties.pdf
[10] https://seekingalpha.com/article/4096931-simon-says-etailers-retailers
[11] https://seekingalpha.com/article/4069069-simon-property-becomes-value-reit
[12] https://www.marketwatch.com/investing/stock/spg

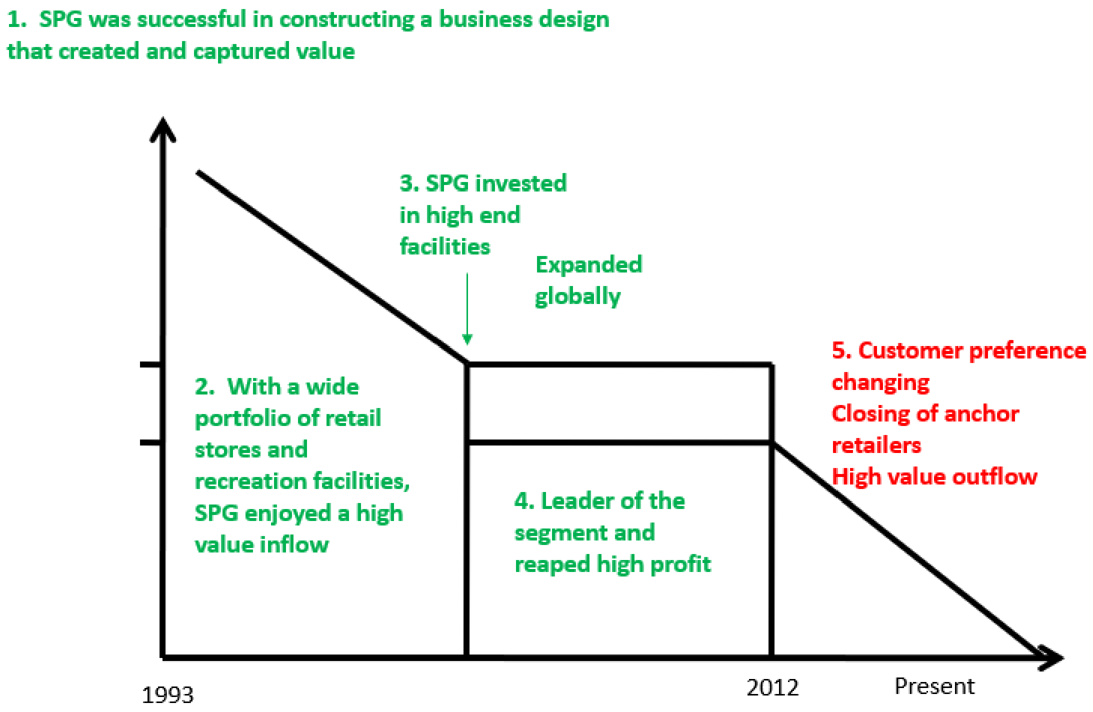

Figure 6: SPG value migration

The reality of malls was that they were the city center where people love to socialize, spend quality time and a hub for a shopping spree. Having its origin in the United States, the shopping malls gained momentum in every other city across the globe attracting huge volumes of people. People would simply go to relax and have a good meal. In Asia, the trend of shopping malls caught on fire with the largest malls in the world being in Asia.

There was a huge real estate boom with the soaring trend of shopping malls, and the SPG group was at the zenith of its expansion. Every retailer wanted a space in these malls irrespective of the cost of the space. SPG became the leader of the real estate and shopping mall spaces with new openings in every other city/suburb. They even expanded globally partnering with big brands. With the advancement of technology and e-commerce, the value provided by shopping malls began to decline.

C.4 Mistakes of the management

Simon enjoyed having great revenue and value inflow for most of their existence. But, as we know, their core business was real estate in the retail space, and in the recent years, retail has been facing a lot of trouble owing to shift in customer preferences. Value migration in retail space from in-store to e-commerce has in-turn resulted in value migration in SPG's business model. Customers increasingly favoring e-commerce has crippled retail industry and in particular, the clothing stores. Two of Simon's top three tenants, Gap. Inc and Abercrombie and Fitch have closed hundreds of stores in the past two years. 15% of U.S malls could be in jeopardy in the next decade, according to Green Street Advisors[13]. All of this value outflow in

[13] "Simon Property Group fights to re-invent the shopping mall" http://fortune.com/simon-mall-landlord-real-estate/

the retail space resulted in value outflow in the business operating as REITs. Let's look at this value migration and analyse if the management at Simon recognized it as such. These are the questions the management should have answered to adapt to the value outflow:

C.4.1 How basic is the threat posed by this migration?

More than 80% of Simon's income generating activities are malls and premium outlets. As retail industry continues to suffer with growth of e-commerce, Simon's current business model of Anchor stores, which revolves around generating foot traffic might become obsolete. The threat posed by this migration is basic to its core business model and needs to be identified as such. Simon did understand the situation identified the outflow, recognized the need to adapt.

C.4.2 How can we protect the value in this business? If we can't, how fast can we get out?

For a business such as Simon, who enjoyed dominance over the years in the REIT space, It was never a question of how fast they can get out. Instead, Simon sought to protect value in the business by reinventing its shopping malls. Simon stayed on top of the changes in customer preferences for brands, quickly replacing their stores with brands on the rise and letting go of the once prominent big brands. Simon has another $1.9 billion investment in renovations and new projects. Many of Simon's spaces have be repurposed for occupants like cheesecake factories and fast fashion retailers. Movie theaters and health clubs are on their list too[7].

C.4.3 What investments in new business designs can we make to capture value that is flowing away?

Simon sought to stop the value outflow by reinventing the customer experience by giving them more reasons to come to the shopping malls, but there were no significant changes in their business models. The company also expanded its portfolio by following customers, investing in new spaces where there is footfall. They've invested in loyalty programs and diversifying the mixture of stores at their malls, again, to generate more traffic. It seems they are still willfully ignoring the fact that customers stopped going to the malls not because of the limited choice of store but predominantly because of the ease of shopping online.

C.4.4 More Problems with current business model

Simon's current business model revolves around their anchor stores. Their anchor stores generate a lot of traffic, and this traffic can be leveraged by the non-anchor smaller scale stores in the mall. For this reason, Simon charges non-anchor stores a lot more than they do anchor stores. Today, the typical anchor store pays $4 per square foot while Simon charges $42.22 per square foot a non-anchor store. However, the customer preferences keep changing. Now, a study shows that customers prefer non-anchor stores as much as they do the big names. According to customers, their mains reasons for going to a mall are shopping and seeking out fashion trends. While anchor stores serve their purpose of shopping, individual non-anchor stores are becoming an increasing source of fashion accessories[14].

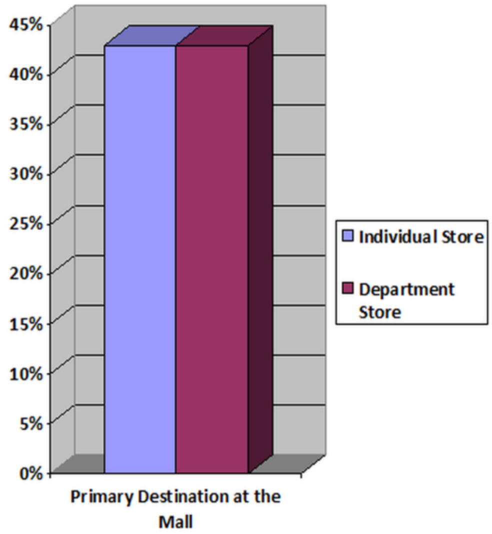

Figure 7: Percentage of people going to anchor and non anchor stores

Now, the problem lies where Simon charges a hefty fee to the non-anchor stores. While the department stores are closing, individual stores can still act as a destination for checking out latest fashion trends. Non-anchor stores will not need to rely on the foot traffic generated by anchors as this trend continues, and if Simon is insistent on charging them high rent, they could quickly lose them.

All of that said, Simon deserves credit for identifying the migration and taking steps to counter and stay relevant. A lot of their competitors and peers have lost their footing. The management at Simon still refuses to acknowledge that their current business model is not foolproof. CEO David Simon claims traffic at the malls is not decreasing and that retailers have been chasing internet sales to the cause of their detriment[15]. The management should have identified the problems with dying retail brick and mortar before they reared their ugly head and diversified their malls, and be welcoming to the non-anchor stores, as they could be the future of the shopping mall experience.

D. Business Model Environment

D.1 Business Model Canvas

Below is the business model canvas for SPG summarizing their resources, activities, relationships and revenue streams.

[14] "Non anchor and anchor stores equally popular among customers" - https://www.forbes.com/sites/prospernow/2013/05/28/nonanchor-and-anchor-stores-equally-popular-among-consumers/#43f4dffb6564

[15] "Simon Property Group fights to re-invent the shopping mall" http://fortune.com/simon-mall-landlord-real-estate/

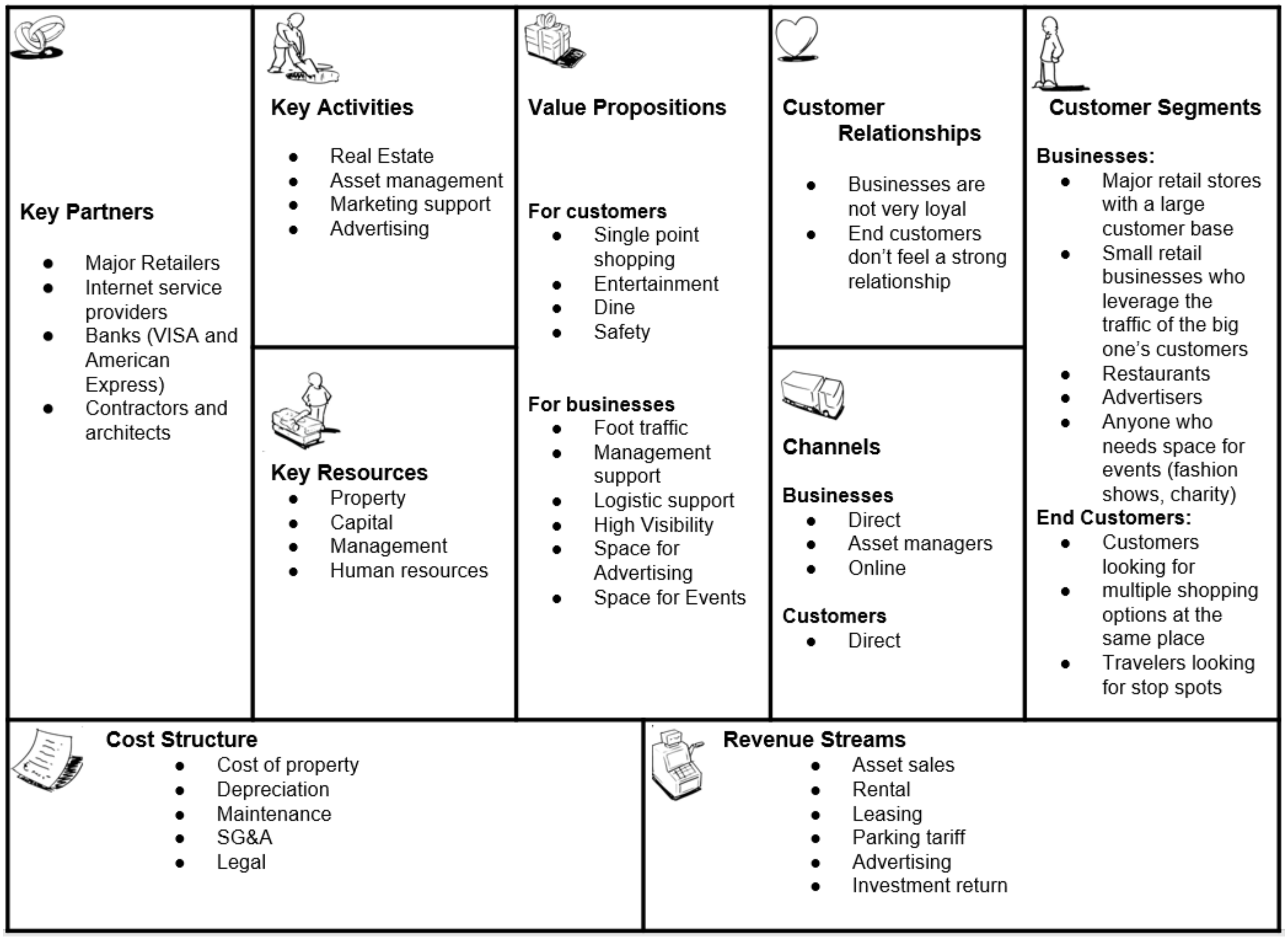

Figure 8: SPG business model canvas

D.2 Key Trends in Malls

Despite being omnipresent, the shopping malls are at a critical inflection point. Increased globalization and culture diversity force the malls to alter the ways they operate. With the online shopping being at its peak, people are no more expecting malls to be an attraction for shopping. They are looking for new value to be created in such spaces due to a change in the behavior of the consumer.

The trends helping to create this change include:

- **A change in the demographics** is a major trend that navigates this change. With the aging population, the people who enjoyed shopping in malls are moving out of the consumer segment. With increased urbanization, people are looking for large spaces to socialize. Malls provide a safe and secure place to congregate where the public spaces are not very safe.
- With people seeking convenience and simplicity, there is a demand for people looking to **work, stay and shop at the same destination** reducing the hassle of transportation. Sustainability concerns are driving consumers to prefer a mixed environment.

- With evolution of e-commerce and digital technologies, there are tremendous services provided to the customers. This arises a need to reshape the functioning of the malls to create a **more entertaining experience than a mere shopping experience**.

There is a strong identity crisis in the US who pioneered in shopping malls and having the highest number of malls. With the economic slowdown and the rapid growth of technology, there is also a continuous increase in the number of deserted and weedy malls in the US[16].

Trends Map

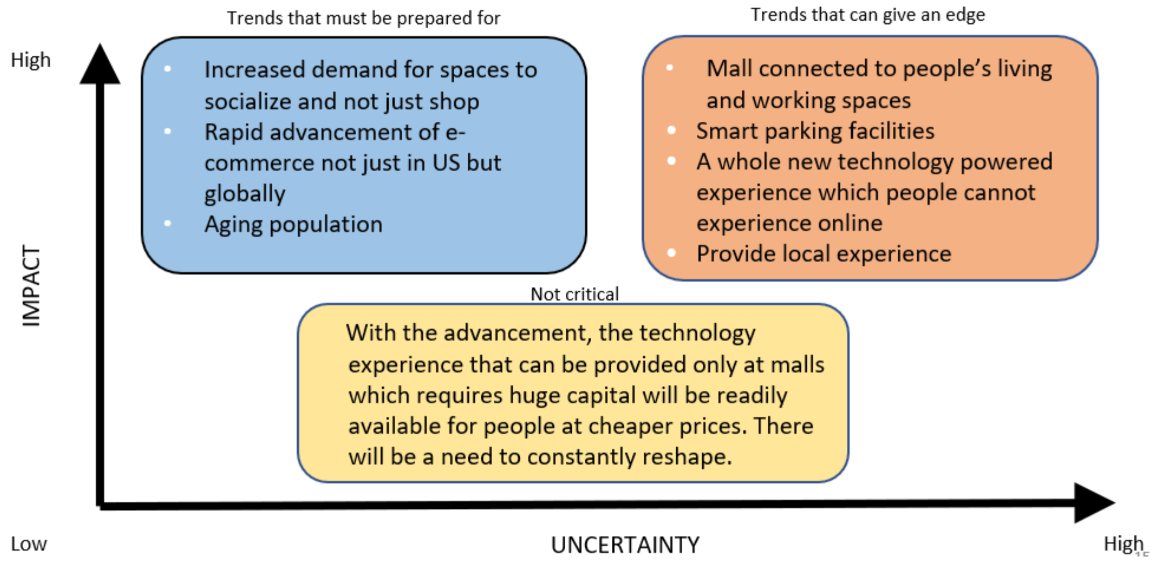

Figure 9: Retail trends map

D.3 Market Forces

The physical Retail industry is getting shaped by changing market forces. Earlier, the e-commerce platform was used by the tech-savvy people, but now the e-commerce players are growing big and mature and disrupting the market with their innovative steps such as same-day delivery and subscription boxes of everyday items. As per a new study by Pew Research, 8 out of 10 Americans are buying online[17]. The rise of people buying online has adversely affected the physical retail. Needs and demands of the shoppers are changing as they can easily check items and their prices online. They are going to physical retail more for the experience. For example, shoppers are trying clothes in fashion outlets and then ordering the one they like online. Switching cost to e-commerce is very low. With a wide variety of products and one-click buying process, e-commerce option has become more attractive to buyers.

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[16] "Meeting Millennials where they shop" - ttps://www.mckinsey.com/industries/capital-projects-and-infrastructure/our-insights/meeting-millennials-where-they-shop-shaping-the-future-of-shopping-malls

[17] "79 percent of Americans now shop online, but it's cost more than ...." 19 Dec. 2016, https://techcrunch.com/2016/12/19/79-percent-of-americans-now-shop-online-but-its-cost-more-than-convenience-that-sways-them/. Accessed 22 Feb. 2018.

D.4 Macro-Economic Forces

Several macroeconomic forces influence the retail industry. Companies cannot change or influence the macroeconomic forces, so they have to adapt as the forces become prevalent[18]. Some of these forces include the role of technology, government, role of economy, social factors, demographic changes, labor market and consumer spending. Out of these forces, role of technology and social factors play significant role in setting the trends in retail. In the recent past, demographic changes, meaning increase in the population of young adults has contributed to the decline of retail sales.

D.5 Industry Forces

Overall, all main competitors of Simon Property Group in the U.S. are focusing on providing a new experience to the end customer. For example:

- *Macerich:* Macerich has over 48 mall properties in the United States, and SPG is trying to acquire it.[19] On its more recent innovations, Macerich is leveraging the technology power in its stores by developing a new interactive store format called WithMe[20], using digital displays from ceiling to floor in the shop. Customers can use digital tables to scan items and then ordering it physically, either in-store to try out, or choosing other delivering options. On a sustainability aspect, Macerich wants to make its properties attractive to customers by using alternative energy technologies for power supply, such as implementing solar panels on parking lots.[21]
- *GGP Inc:* GGP has over 126 retail properties in the U.S. On its more recent innovations, GGP is currently collaborating with LifeTime[22] to transform its malls into more resort-like healthy destinations, for all ages: change the "the way people shop, live, eat, work, socialize, exercise, and seek medical care" said Sandeep Mathrani, GGP Chief Executive Officer. Malls are intended to become more like small villages. GGP is also implementing several sustainability practices.
- *Taubman Centers:* Taubman Centers has over 25 premier shopping centers in the U.S. During holidays, it focuses on providing immersive holiday experiences to children and guests with more hands-on engagement.[23]

- *Online retailers*, such as Amazon, provide the possibility of shopping from home without the hassle of transportation to the mall

[18] http://smallbusiness.chron.com/role-macro-environment-retail-industry-33419.html
[19] http://investors.simon.com/phoenix.zhtml?c=113968&p=irol-newsArticle&ID=2023804
[20] http://www.altavia-group.com/en/innovative-retail-concept-combines-offline-and-online-at-the-mall/
[21] https://www.reit.com/news/podcasts/macerich-sees-importance-sustainability-attracting-shoppers
[22] https://www.prnewswire.com/news-releases/ggp-and-life-time-partner-in-retail-shopping-centers-300439202.html
[23] https://insights.ges.com/retail-experiences/tuabman-shopping-centers-ice-palace

E. Jobs to be Done

Simon Property Group (SPG) creates value by enabling interaction between retailers and their customers and because of that we consider SPG a Multi-sided platform. This means even though we only lease space out to retailers, we also consider their end customers as our customers. As such we believe the jobs to be done:

- For our retail customers is to provide them adequate retail space in an area that promises high and constant traffic volume of their target customer.
- For the end, customer is to provide access to entertainment and a great shopping experience

SPG can't focus on one side of the platform over the other because they're both interdependent. Retailers need to be in an adequate space where their target customers frequent and customers need easy access to an adequate shopping and entertainment experience.

F. Recommendations to create value inflow

Based on the job to be done for Simon Property Group's (SPG) customers, we are classifying recommendations for SPG into:

1. Recommendations to manage their (SPG) location portfolio.
2. Recommendations to provide value to their retail customers
3. Recommendations to provide value to end customers

F.1 Recommendations to manage their (SPG) location portfolio

1. **Reduce their asset footprint and maximize use of the remaining malls**. We believe SPG need to divest from real estate holdings with a high vacancy rate or with a low rate of human traffic. We also believe they should reduce their coverage in areas with unreasonably high coverage. For example, in central Texas SPG owns five properties: Barton Creek Square; Lakeline Mall; Round Rock premium outlets; San Marcos Premium outlets; and the Domain. This is an oversaturated market, and they can scale down their holdings in this area and maximize the traffic to the remaining stores.

2. In accord with recommendation F.3.1, in the spirit of creating "microcities," for malls already existing out of the cities or in suburban areas where there is a lack of public transportation, **invest in developing apartments/hotel buildings near the malls** to attract the customers, tourists and corporations.

3. For malls existing out of the cities or in suburban areas, **partner with the cities/local engineering schools** to develop a better and faster public transportation system.

Potentially, **partner with Uber/Lyft** in the areas where customers are not used have car ownership, so that they might have transportation discounts when coming to the store.

F.2 Recommendations to provide value to their retail customers

1. Target **high margin and high-end retailers**. Rather than focus on mass-market brands like Macy's and J.C. Penny, SPG can target higher-end retailers that need to maintain an offline store presence because a large part of their value proposition to their customers is visible exclusivity and luxury. These retailers will be less likely to move completely offline, and their end customers have more disposable income and will be willing to visit and shop at other retailers at SPG locations.

2. Work with **established eCommerce retailers** like Warby Parker, Bonobos and RentTheRunway to provide an offline experience for their customers. With the growth of eCommerce, some retailers have grown rapidly by focusing on online growth. The next stage of their growth will include creating an offline presence to attract the more skeptical buyer or buyer who need some physical experience to make their buying decision. SPG can go after these retailers and work with them to create the ideal shopping experience for their target customer in a way that matches the experience provided online.

3. Repurpose empty and un-leased spaces by **creating coworking spaces f**or small to medium enterprises. SPG can also get into the coworking space market by repurposing empty spaces by turning them into coworking spaces. In the coworking space, the clear leader is WeWork and SPG can easily compete because they have an enviable amount of prime real estate that is attractive to small to medium enterprises.

4. Empty spaces can also be leased to **indoor farming - community gardens.** This is an adjacent rising trend in the farming industry that has the potential of disrupting the way to have fresh and local food. This could be leased to either people living in the mall's apartments, either directly to restaurants inside SPG malls so that they can deliver high quality & guaranteed fresh food to their customers.

F.3 Recommendations to provide value to end customers

1. Instead of creating malls, we suggest SPG to **create micro cities**. These cities should consists of more apartments than what already exist, but also entertainment centers, like bars, cinemas and concert centers, shopping stores, fitness centers, and office buildings. These micro cities create great value for end customers because it brings them close to all the stores they want to go to. Unlike the old paradigm where customers had to drive out of cities to go shopping, in this scenario, customers are close to most of their shopping needs and are incentivized to go shopping because of

its proximity to places they have to go like entertainment centers, work and fitness centers.

2. Increase **share of stores that are higher end restaurants** to attract customers and traffic.

3. Invest in **experiential technology like virtual reality and augmented reality.** SPG can create experiences around novel technologies like VR & AR to attract a significant amount of foot traffic. Like with the theme park in the middle of the Mall of America in Minnesota, SPG can create experiences around VR & AR that are uncommon to customers and add to the value of visiting an SPG property.

4. If Macerich cannot be acquired immediately, focus on **building partnerships with digital architects** to reinvent the whole experience in outlet stores thanks to technology. Macerich's new WithMe store is a good example of that.

5. Create **events centered around notable people** like inviting celebrities, notable chefs and artists.