

Economic Impact Analysis: A Case Study

Local Merchants
vs.
Chain Retailers

COMPLETE REPORT

Prepared for

liveablecity

&



by

CIVIC **ECONOMICS**

CREATIVITY · OPPORTUNITY · PROSPERITY

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INTRODUCTION

Civic Economics is pleased to present Liveable City with this Economic Impact Analysis assessing the economic impact of local merchants relative to a chain merchant carrying comparable lines of goods. Sixth and Lamar, specifically BookPeople, Waterloo Records, and Borders Books & Music, provide a case study.

The National Context

American communities from coast to coast have wrestled with the implications of national chain retail. In many small communities, the issue comes to a head with the imminent arrival of a large discount store, and manifests itself in an anti-Wal-Mart campaign. In others, the desperate quest for sales tax revenues places public officials squarely on the side of national merchants. Few would argue that chain stores have no place in a large community such as Austin. In many cases these stores expand consumer choice and offer good consumer value.

Despite national interest, however, CivEc has identified a near absence of objective, fact-based analysis of the phenomenon. Proponents and opponents alike present broad arguments based on emotional or philosophical pleas, for “mom and pop” shops and local character on one side and for free markets and consumer choice on the other. This report is designed to enhance the discussion by providing a credible and quantifiable analysis.

The Local Context

The area of Sixth Street and Lamar Boulevard in central Austin provides an outstanding opportunity to study the dynamics of retail competition. The following analyses are put forth as a case study of the interaction among co-locating chain and local merchants in similar lines of goods.

There can be no doubt that development of the properties in question is in the public interest. The corner of Sixth and Lamar is destined to become a retail, residential, and office hub for the region. Austin policymakers have wisely promoted this outcome. However, few seriously contend that the composition of this development is unimportant. Austin’s smart growth, great streets, and downtown development policies are carefully crafted to promote the health of the city by providing developers with incentives for preferred behaviors.

This analysis demonstrates a clear failure of public policy to steer desirable development at the site in question. As presently configured, new development at the corner will yield a net loss to the local economy. Moreover, previous decisions have placed the city in the position of subsidizing such an outcome.

Schlosser Development Corp. presently controls the two blocks between Fifth and Sixth to the east of Lamar as well as the previously developed block to the south, containing Office Max, Starbucks, and an AT&T Phone Store. Should the development proceed as

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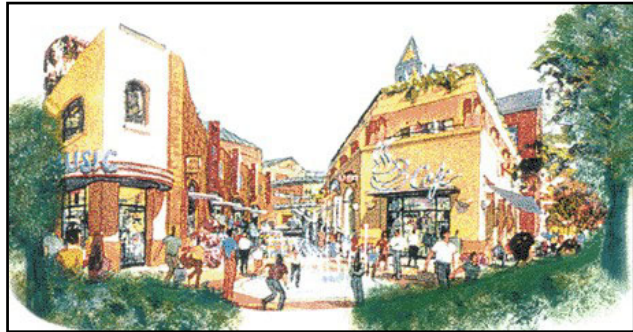
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presently structured, Schlosser will additionally take on leasing responsibilities at the present Whole Foods and BookPeople complex.

Under the present proposal, the offices and flagship store of Whole Foods Market will occupy the prime block of the Schlosser site. Whole Foods is a genuine Austin success story, growing in 20 years from a single Lamar store to a national chain with 137 outlets and growing. Whole Foods became a publicly traded company in 1992 (Nasdaq: WFM). Much of the company's expansion has come through acquisition of 12 local chains around the nation.

Schlosser proposes to anchor the eastern block with a Borders Books & Music store. Borders, like Whole Foods, is a hometown success story in a college town. From the first store in Ann Arbor, Borders has grown into the second largest national retailer of books and music. After a brief stint as a subsidiary of K-Mart, Borders was spun out in 1997 and now trades as BGI, the holding company for Borders and Waldenbooks.

As originally presented to the City, the Schlosser development on the site was to be an "urban village," albeit one with a Target store for an anchor. This proposal (at left), featuring the design work of internationally recognized Jerde Partnership, was approved for substantial public incentives. Unfortunately, after clearing and grading the site and closing a public street, the project was postponed due to financing difficulties. The project was resurrected in the summer of 2002 in the present configuration.



According to published sources, the combined Schlosser properties have been granted incentives with a total value of over \$2.1 Million. These include fee waivers, water and wastewater infrastructure reimbursements, drainage improvements, and a temporary use of right-of-way fee waiver. The projects have thus far received approximately \$710,000 of these incentives. Additionally, the developers have entered into an agreement with Austin Energy for the provision of a chilled water facility valued at approximately \$3.5 Million.

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EXECUTIVE SUMMARY

Civic Economics (CivEc) is pleased to present this Economic Impact Analysis assessing the economic activity generated by local merchants relative to a chain merchant carrying comparable lines of goods. Economic impact, for the purposes of this case study, is based on locally focused expenditures of the merchants, including such items as labor, profits, goods, and services.

PRINCIPAL FINDINGS: THREE ESSENTIAL FACTS

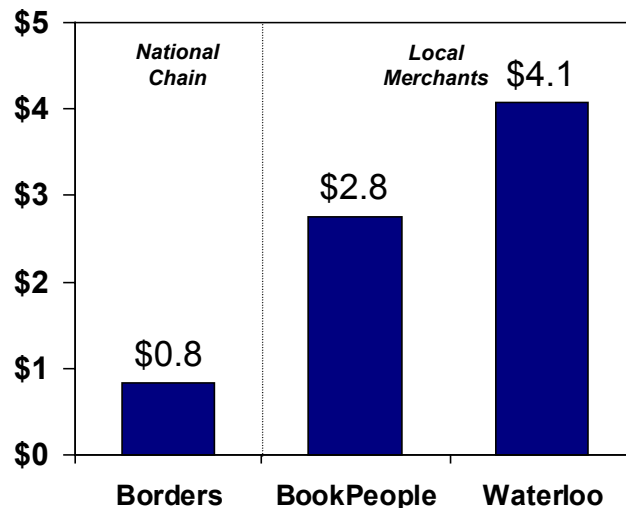
FACT: Local merchants generate substantially greater economic impact than chain retailers.

CivEc initially compared the local economic impact of three freestanding stores, a typical Borders, and the existing and known quantities of BookPeople and Waterloo.

Three distinctions account for the dramatic difference seen in the chart at right:

1. Local merchants spend a much larger portion of total revenue on local labor to run the enterprise and sell the merchandise.
2. Local merchants keep their modest profits in the local economy.
3. Local merchants provide strong support for local artists and authors, creating further local economic impact.

Annual Economic Impact per Store
(millions in 2002)



FACT: Development of urban sites with directly competitive chain merchants will reduce the overall vigor of the local economy.

Development of a Borders store at Sixth and Lamar will reduce the vigor of the Austin economy. In this analysis, CivEc reviewed three scenarios to account for the range of impacts possible. In all three, Borders triggers a decline in local economic activity despite increasing total sales of books and music at the corner.

**Competitive Effects:
Borders Impact over Five Years**
Total book and music sales **increase**
Economic returns **decrease**

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CivEc puts forth two alternative outcomes in which the neighborhood and the Austin economy will be enhanced:

1. New merchants bring a new line of goods to the market, attracting additional consumer traffic to the area to the benefit of neighboring merchants. For example, former plans called for a cinema at the site. This would have offered a product previously unavailable at Sixth and Lamar, drawing additional prospective customers for all neighboring merchants.
2. New merchants bring a complementary line of goods to the market, leading to increased browsing among merchants with similar but unique lines of goods. For example, there exists in the neighborhood a cluster of antiques and home goods shops. Shoppers for these goods are induced to visit several merchants, as unique yet related items are offered in each shop.

As presently configured, the City of Austin is asked to subsidize a development that actually does damage to the local economy.

FACT: Modest changes in consumer spending habits can generate substantial local economic impact.

For every \$100 in consumer spending at Borders, the total local economic impact is only \$13. The same amount spent with a local merchant yields more than three times the local economic impact.

If each household in Travis County simply redirected just \$100 of planned holiday spending from chain stores to locally owned merchants, the local economic impact would reach approximately \$10 Million.



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ECONOMIC IMPACT ANALYSIS: LOCAL MERCHANTS vs. CHAIN RETAILERS

This report is divided into three sections, which present similar data in different formats for different audiences.

SECTION I: COMPARATIVE ECONOMIC IMPACT ANALYSIS presents a baseline assessment of the economic impacts of three different, freestanding stores: BookPeople, Waterloo, and a typical Borders. It provides much of the underlying data for subsequent analysis.

SECTION II: COMPETITIVE EFFECTS ANALYSIS is aimed squarely at policymakers. It provides a five-year forecast of the likely effect of competition at Sixth and Lamar.

SECTION III: PROPORTIONATE ECONOMIC IMPACT ANALYSIS is aimed squarely at consumers. It provides shoppers with an understanding of the implications of our purchasing decisions.

Civic Economics has withheld a small amount of the underlying data in order to protect the privacy and business practices of the local merchants in question. Questions regarding methodology and findings should be directed to:

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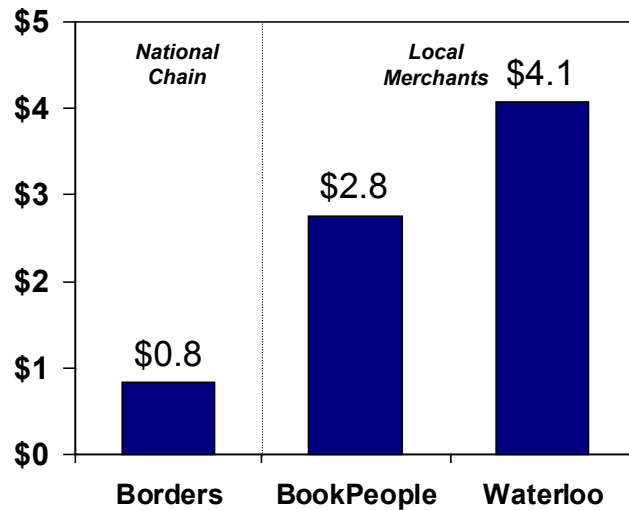
SECTION I: COMPARATIVE ECONOMIC IMPACT ANALYSIS

Locally owned and operated merchants generally have greater impacts on local economies than outlets of national chains due to three primary classes of expenditure.

First, spending on **local labor** typically comprises a greater share of operating costs for a locally owned establishment than an outlet of a national chain. While the latter is able to consolidate the vast majority of its administrative functions, such as bookkeeping and advertising, at its national headquarters, an independently owned store carries out those functions in the community.

Additionally, “economies of scale” and carefully engineered store layouts may allow national chains to employ fewer sales staff than locally based stores.

Annual Economic Impact per Store
(*millions in 2002*)



Next, large national chains purchase fewer **goods and services** in the markets they serve. Their products, advertising, and supplies are usually procured at the national level. By contrast, local stores may purchase a substantial portion of these goods and services from other local firms, keeping that money in the community. Additionally, local bookstores and record stores are often the sole outlets for retail sales of books and recordings by local authors and artists. Particularly for authors and artists with self-published works, such as local bands selling music on consignment, the bulk of sales receipts remain local. National chain stores stock few such items.

Finally, a larger portion of **profits** earned by owners of local stores remains in the local economy. Once a purchase is made at a nationally owned store, the profits from that sale go directly to the headquarters outside the region, perhaps to be distributed to stockholders worldwide. The owners of local establishments, by contrast, are members of the local community, residing in nearby neighborhoods and spending their earnings on goods and services locally or supporting local organizations.

Chart 1 presents the first standard dataset of an economic impact assessment, the combined direct and indirect economic impacts of each store. In this analysis, CivEc reviewed the local employment and spending patterns of each merchant, using actual data from BookPeople and Waterloo, and a typical Borders store, all in 2002. Details of the underlying data, assumptions, and methodology have been withheld to protect the privacy and business practices of the local merchants.

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For the purposes of this report, **direct impacts** are identified as all local expenditures by the store. For example, wages and benefits paid to employees remain local, as does local advertising spending, purchases from local suppliers, and, in the case of the local merchants, profit. By including off-site expenditures as part of the direct impact, this analysis is able to incorporate the marked difference between these purchases made by local establishments and national franchises. In a simple economic impact analysis, off-site expenditures are viewed as indirect impacts, to be estimated by the application of multipliers. However, in this case, such a treatment would yield inaccurate results by estimating that local merchants and chain outlets purchase equal shares of goods and services locally.

Calculation of **indirect impacts** seeks to quantify the further effects of direct impact funds as they circulate in the local economy. Indirect impacts are calculated using **multipliers**, which estimate the degree of circulation expected. The cost of goods for each store, which includes wholesale purchases of merchandise and the space in which to sell it, are not included in the calculations. These indirect impacts also include **induced effects**, accounting for increased household spending brought about by additional local economic activity.

CivEc here utilized conservative, industry standard multipliers, calculated by a nationally respected firm using a sophisticated input-output model of the Austin economy. To protect the privacy and business practices, the precise values of those multipliers cannot be provided in the published version of this report.

Our analysis reveals that the typical Borders store generates total local economic impact of just over \$820,000.

By contrast, BookPeople generates total a local economic impact of \$2.8 Million.

Similarly, Waterloo generates local economic impact of \$4.1 Million.

It must be noted that this is a net economic impact and not a fiscal analysis. This local impact does not seek to determine the amount of revenue each will deliver to the local governmental units involved. Such tax revenue will be similar whether new retailers at the site are a competitive threat to other independent businesses nearby or not.

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SECTION II: COMPETITIVE EFFECTS ANALYSIS

Underlying Assumptions

The analysis described above calculates the economic impact of the three stores in the present year. However, to address the situation at Sixth and Lamar requires consideration of the effect of direct competition at the corner. CivEc has, therefore, formulated a set of assumptions about the performance of these stores in the future and in competition. For the purposes of this study, 2004 has been treated as year one of competition.

Competitive Effects:

Borders introduces no new products to the market, either at the corner or in Austin.

Approximately 50% of revenue at a new Borders will be diverted from BookPeople and Waterloo.

Assumption 1: According to recent annual reports of Borders Group Inc., the average Borders nationwide will achieve sales of approximately \$6.5 Million in 2002. However, given the expected intensity of competition in comparable merchandise at Sixth and Lamar, we do not believe that this Borders store will perform as well. We have thus assumed a Borders store with first year revenues of \$4.7 Million. It should be noted that Borders Stores closed only one outlet in 2001, indicating a willingness to maintain under performing stores for sustained periods. Additionally, our analysis demonstrates that should Borders perform substantially better than projected here, local merchants BookPeople and Waterloo would face extreme challenges to remaining in business.

Assumption 2: The calculation begins with projected revenues for BookPeople and Waterloo, provided by the merchants themselves. In the absence of a Borders at the corner, both project modest annual increases over the coming years. To validate these assumptions, CivEc studied recent retail sales trends (books, music, and overall retail sales) for a large area of central Austin. Books, music, and general retail all sustained strong gains over the last ten years, with a modest decline in 2001. Based upon 2002 sales figures for BookPeople and Waterloo, continuation of modest annual gains is a reasonable assumption.

Assumption 3: CivEc again studied retail sales trends for the region to estimate the likely effect of competition among the stores. Given the similar product mix and nearly identical pricing of those goods, we assumed that approximately 50% of Borders sales at this location would represent sales diverted from BookPeople and Waterloo. This assumption is supported by historical retail data showing consistent but modest increases in book and music sales locally. Given Borders' emphasis on books and the duplication of inventory at BookPeople, we assumed that diverted sales would weigh more heavily on BookPeople than on Waterloo. As to the other 50% of sales, that revenue is likely to be drawn primarily from other merchants throughout the metropolitan area, though a new Borders location may be expected to induce a very small amount of new book and music spending in the region.

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Assumption 4: Finally, CivEc formulated three likely outcomes in succeeding years. In the first, labeled the Basic Borders, the Borders store is projected to gain revenues at an annual rate of 2%, in line with both the industry overall and with the chain's same-store sales in recent years. In the second, labeled the Weak Borders case, Borders is projected to lose revenues at an annual rate of 3% as local competitors retake lost market share. In the third, labeled the Strong Borders case, Borders is projected to consolidate its position and gain revenues at an annual rate of 7%. For the local merchants, we also include a No Borders scenario, using the projected revenues described in Assumption 2.

All charts in the remainder of Section 1 incorporate variations on these assumptions and scenarios. As with other analyses in this report, details of revenue forecasts are withheld to protect the privacy and business practices of BookPeople and Waterloo.

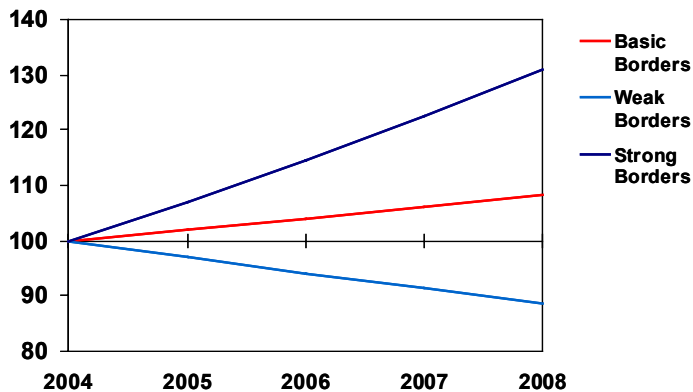
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Competitive Effects Scenarios

The following charts illustrate the range of competitive effects for Borders, BookPeople, and Waterloo.

Borders Sales Forecast, '04 to '08
(Indexed: 2004 Sales = 100)



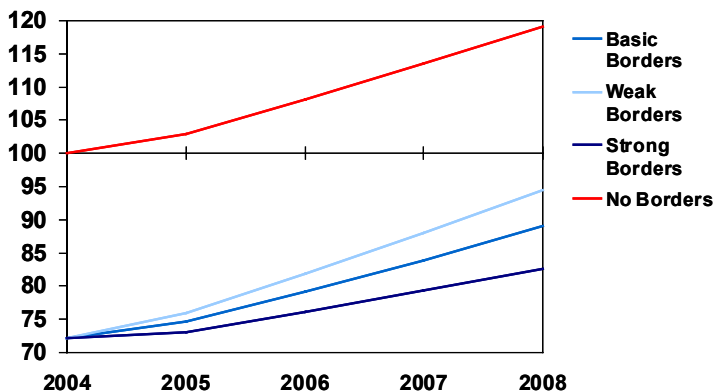
Borders sales are forecast to begin at \$4.7 Million, and rise to nearly \$5.1 Million in the Base Case, with high and low projections of \$6.1 Million and \$4.1 Million by 2008.

In these projections, sales diverted from BookPeople and Waterloo will be expected to total between \$11 Million and \$14 Million over the course of five years.

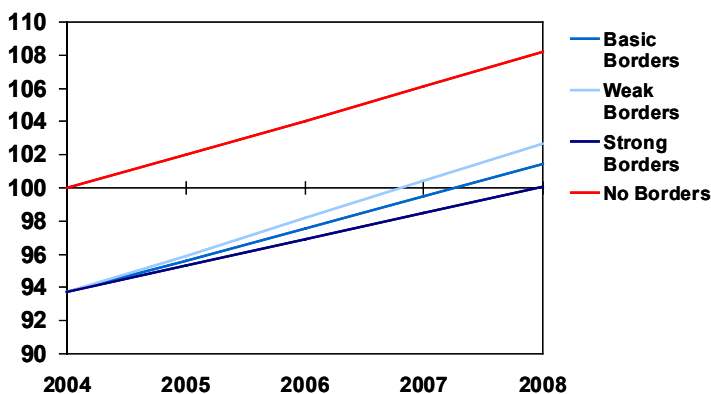
At first glance, these projections might appear extreme. However, the present situation is particularly clear. This study involves merchants selling very similar lines of goods at nearly identical prices so the competition will be intense.

We have no doubt that the first year of competition at the corner will produce profound changes in revenue for BookPeople and Waterloo. Moving forward, similarly strong effects will be felt as competition settles into a pattern.

BookPeople Sales Forecast, '04 to '08
(Indexed: 2004 Sales = 100)



Waterloo Sales Forecast, '04 to '08
(Indexed: 2004 Sales = 100)



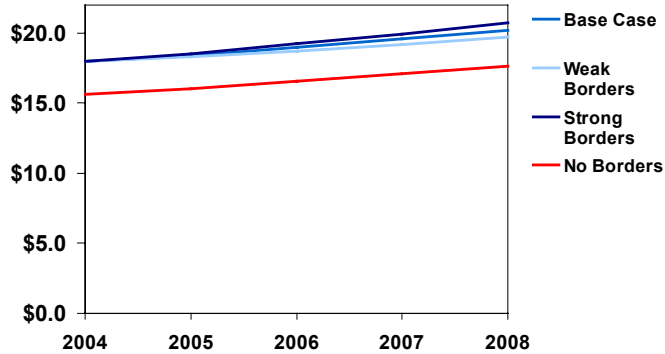
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Economic Impact of Competition

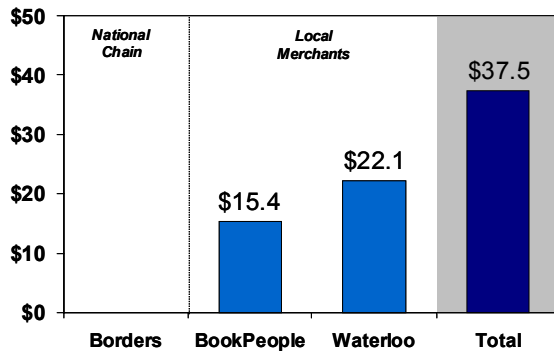
At first glance, citizens and policymakers might view the scenarios above as the result of healthy competition, enhancing consumer choice and value. Indeed, in such a dynamic marketplace as Austin, such shifts are taking place every day in every line of merchandise. In all of the scenarios, total sales of books and music (and therefore total sales tax revenue) at the intersection will increase.

Total Sales Forecast, Books & Music, '04 to '08
(millions)

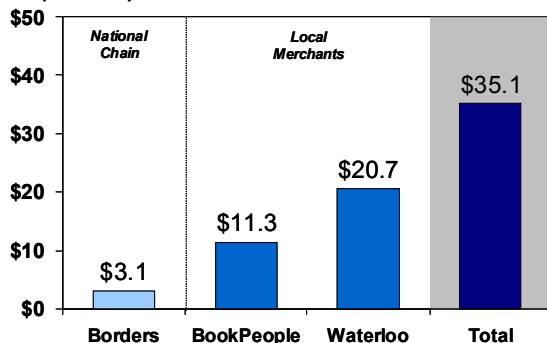


However, the total return to the community entails activity beyond retail sales and sales tax collections at a given location. The economic health of the city is impacted as well by wages paid to local residents, by materials and supplies purchased locally, and by the reinvestment of profits in the business and in the community. These factors are the building blocks of economic impact.

Cumulative Gross Impact
without Borders, '04 thru '08
(millions)



Cumulative Gross Impact
with Base Case Borders, '04 thru '08
(millions)



CivEc undertook to analyze the economic impact on the local economy of each of these scenarios. In making these calculations, we assumed that all merchants would increase or reduce expenses in proportion to changed revenue. In the Strong Borders scenario, for example, Waterloo will be expected to experience a decline in revenue of 7%. Therefore, the analysis incorporates a 7% reduction in expenditures for labor, materials, and services purchased locally.

In every scenario above, despite additional total sales, **the total economic activity generated by these merchants is projected to decline after the opening of a Borders and Sixth and Lamar.**

This counterintuitive outcome occurs because every dollar drawn away from a locally owned merchant by a chain store results in a net loss to the local economy. Activity generated by new sales does not replace the activity lost in that diversion of sales.

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Policy Implications

Policymakers often feel compelled to draw chain retailers into a jurisdiction as a means of increasing sales tax collections, an apparently painless way of maintaining necessary government services without resorting to tax increases. If we look only at the corner of Sixth and Lamar, sales tax collections will indeed increase if a Borders opens. That is true, however, regardless of what opens on that site.

In the case at hand, increasing sales tax revenues by siting a chain store directly across from local merchants selling similar goods at similar prices actually results in reduced economic activity.

This analysis clearly demonstrates that public goals will be better served by promoting alternative retail options at the corner.

Alternative Outcomes:

- New merchants bring a new line of goods to the market
- New merchants bring a complementary line of goods to the market
- New merchants contribute to local economic vitality

Two scenarios present more desirable outcomes:

1. New merchants bring a new line of goods to the market, attracting additional consumer traffic to the area to the benefit of neighboring merchants. For example, former plans called for a cinema at the site. This would have offered a product previously unavailable at Sixth and Lamar, drawing additional prospective customers for all neighboring merchants.
2. New merchants bring a complementary line of goods to the market, leading to increased browsing among merchants with similar but unique lines of goods. For example, there exists in the neighborhood a cluster of antiques and home goods shops. Shoppers for these goods are induced to visit several merchants, as unique yet related items are offered in each shop.

A policy preference for local merchants will produce even greater economic vitality.

Current smart growth policy and downtown development programs have created the in this situation the unfortunate side effect of offering financial and development assistance to a project that will actually sap economic vitality from the urban core.

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SECTION III: PROPORTIONATE ECONOMIC IMPACT

The economic impact analysis above provides compelling evidence of the public benefits of local merchants relative to chain retailers. How might consumers use this information to modify spending habits? The following analysis identifies the relative value provided to consumers and the economic impact of their spending.

Value to Consumers

CivEc, with BookPeople and Waterloo staff, prepared shopping lists for comparison. These selections were not made in a scientific manner, merchants were simply instructed to identify five titles in each of five categories of books or music. They did not engage in comparison shopping before making these lists. CivEc then undertook to compare the availability and cost of these items at each store.

In the case of books, it is clear that Borders is not a “discount store.” In this atypical industry, prices are printed on the product at the factory, and both BookPeople and Borders use those prices in nearly every case. Every item on the shopping list was priced the same at both merchants. Moreover, approximately 30% of these items were out of stock at the Borders store used for comparison.

Value to Consumers:

Prices for books and music are nearly equal at Borders, BookPeople, and Waterloo.

30% of comparison shopping selections were not in stock at Borders.

In the case of recorded music, comparison shopping proves more difficult. Austin’s Waterloo Records is among the top performing independent record stores in the nation, and stocks an extraordinary variety of titles, from the latest popular music to the most obscure local bands. For those titles on the shopping list that were in stock in both places, aggregated prices were essentially equal, though price advantages among titles varied considerably. In an independent comparison-shopping exercise, the Austin American-Statesman recently found a savings of 8.5% at Waterloo versus Borders. (“At What Price Music,” Austin American-Statesman, December 5, 2002).

Consumers seeking the most popular titles and artists receive equal value at each of the three merchants studied. However, the consumer whose tastes run to more esoteric books or local music is far better served at BookPeople and Waterloo. Indeed, these findings emphasize the homogenizing effect of chain retailers. The consumer who shops only at Borders may remain unaware of many artists and authors outside the mainstream of the publishing and recording industries.

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Local Impact

Having established comparable value and better selection, CivEc then calculated the local economic impact of \$100 in consumer spending at each of the three stores.

When the consumer spends \$100 at Borders, approximately \$9 remains in Austin, primarily in the form of employee salaries. The remainder is transferred out of the city almost immediately, in the form of wholesale expenses, administrative costs incurred elsewhere, and profits. Applying industry standard multipliers to calculate total economic impacts, this \$100 spent yields a total of \$13 in local economic impact.



By contrast, consider that same \$100 spent at BookPeople or Waterloo. There, as much as \$30 is directly injected into the local economy. Again, much of this is kept local in the form of employee salaries, but with local merchants administrative expenses and profits are also directly placed into the Austin economy. Applying the same multipliers to calculate total economic impacts, this \$100 spent yields a total of over \$45 in local economic impact.

Consider this: If each household in Travis County redirected just \$100 in holiday spending, the local economic impact of that simple act would reach approximately \$10 Million.

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ABOUT THE PROJECT PARTICIPANTS

LiveableCity Austin is an inclusive network of individuals working together to create a community consensus to promote policies that address the long term social, environmental and economic needs of the people of Austin.



Civic Economics (CivEc) is an economic analysis and strategic planning consultancy with offices in Austin and Chicago.

BookPeople and Waterloo Records and Video provided additional funding and research support for this study, with support from the Austin Independent Business Alliance.

For further information about the project participants or this Economic Impact Assessment, please contact:

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