EXCLUSIVE

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The "common wealth" scam in India's shopping centre industry

In any revenue share arrangement or transaction between a shopping centre Owner and its Tenant, the Net Revenue (or turnover) accruing to the Tenant (retailer) is supposed to be shared as their "common wealth". So, is everything really hunky-dory in this space or are mall developers / owners being taken for a ride? In other words, is this form of transaction our industry's very own commonwealth scam?

To find out, we first need to understand how "Net Revenue" is defined. Net Revenue should be the total consideration accruing (whether received or not) to the Tenant and also all the sub-lessees, concessionaires, franchisees and sub-Tenants of the Tenant (including shop-in-shop counters) and any third party operating from the Leased Premises from all business of whatsoever nature (in cash or on credit) conducted on or from the Leased Premises and whether by way of sale or exchange, or commission or otherwise, of goods, wares, merchandise and services (including financial services) performed, together with the amount of all orders (including but not limited to mail, internet and telephone orders) fulfilled or delivered from the Leased Premises, irrespective of where delivery is effected, and all sales completed by delivery at the Leased Premises or elsewhere, and all sales made by means of vending devices in the Premises.

What this means is that: (a) If one or more departments/divisions of the business carried out at/from the Leased Premises is sub-leased by the Tenant or is conducted by any person or entity other than the Tenant (including an entity in which the Tenant has an interest), then the gross revenue of such departments or divisions are to be included in the Net Revenue and shall have the same effect as if the business of such departments had been conducted by the Tenant itself; (b) The Net Revenue should not include any amounts collected and paid out by the Tenant to any statutory authority in respect of any taxes, levies or cess, including VAT, sales tax, service tax, entertainment tax or any other similar levy of a like nature; (c) The Net Revenue should include any and all consideration received by the Tenant from any advertisement or publicity or space on hire (vide hoardings, billboards, promotional displays, events, glow signs, banners, standees or in any other manner whatsoever) of any brand or merchandise in the Leased Premises from any third party including manufacturers/ wholesalers/distributors of any merchandise sold/traded by the Tenant; (d) The Net Revenue should not include discounts/rebates given to customers and sales of merchandise for which payment is received but subsequently refunded by the Tenant to the customer; (e) Sales of gift vouchers from the Leased Premises should be excluded but gift vouchers redeemed at the Leased Premises shall be included in the Net Revenue. There are a few other considerations that need to be captured in the legal document executed between the parties and I will not get into such minor details in this article.

Let me now rephrase the above paragraph in simpler language which will be easily understood by those who may not understand such legalese. Let us assume that department store chain Northstop has taken up 100,000 square feet of space in an upcoming shopping centre (we'll call it Centramall or just refer to it as the mall) in Mumbai, being developed by Maxima Developers.

The transaction between Maxima Developers and Northstop is based on 6% revenue share or a minimum guaranteed rent (MG) of ₹55 lakhs per month, whichever is higher; and the deal has been done by leading brokerage house Medhraj & Sons.

DISCLAIMER: All Names In This Case Example/Study Are Assumed/ Fictitious Names. Any Resemblance To Someone Operating The Same Business Under A Similar Or Same Name Is Totally Unintentional.

Within this 100,000 square feet space, Northstop gives (on a sub-lease or concession) 2000 square feet to Coffeebits to put up a café, another 2000 square feet to Smartcuts for a salon, 3000 square feet to Kanishka Diamonds to set up a jewellery shop on a SIS (shop-in-shop) basis, 1000 square feet to Eye Express for an eyewear department, 1000 square feet to Deepika's Secret for a lingerie SIS and 15,000 square feet to Home City to run the home department.

So, in all, we have assumed that Northstop has sub-leased 24,000 square feet of space to the various specialist retailers / service providers named above. Northstop also keeps an additional 1000 square feet vacant to use as "space on hire" for promotions/displays, etc.

In the first year of operations of this 100,000 square feet Northstop department store in Centramall, we assume that Kanishka Diamonds does sales (net of VAT) of ₹160 lakhs per month and pays Northstop ₹4 lakhs per month by way of revenue share (RevShare) @ 2.5 per cent. Home City does net sales of ₹150 lakhs per month and pays Northstop ₹15 lakhs per month RevShare @ 10 per cent. Deepika's Secret does net sales of ₹25 lakhs per month and pays Northstop ₹5 lakhs per month RevShare @ 20 per cent. Eye Express does net sales of ₹20 lakhs per month and pays Northstop ₹3 lakhs per month RevShare @ 15 per cent. Smartcuts does net sales (net of Service tax) of ₹8 lakhs per month and pays Northstop ₹2 lakhs per month RevShare @ 25 per cent. Coffeebits also does net sales of ₹8 lakhs per month and pays Northstop ₹2 lakhs per month RevShare @ 25 per cent.

From the 75,000 square feet space managed directly by the anchor itself, Northstop does net sales of ₹11 crores per month. Out of this, ₹50 lakhs comprises redemption of merchandise against Gift Vouchers sold at another Northstop store in Delhi; and another ₹50 lakhs comprises telephone orders received at Northstop's store at Centramall,

Sl.	Particulars	Formula	(All figures in Rs. Lakhs/month unless specified)							
			Northstop STANDALONE	Coffeebits	Coffeebits	Kanishka Diamonds	Eye Express	Deepika's Secret	Home City	Northstop CONSOLIDATED
A	Net Revenue from Sales in the store	-	1000.00	8.00	8.00	160.00	20.00	25.00	150.00	1371.00
B	Net Revenue from Redemptions of gift vouchers	-	50.00	0.00	0.00	0.00	0.00	0.00	0.00	50.00
C	Net Revenue from home delivery against Phone Orders	-	50.00	0.00	0.00	0.00	0.00	0.00	0.00	50.00
D	Net Revenue from Space On Hire (promotions/displays)	-	100.00	0.00	0.00	0.00	0.00	0.00	0.00	100.00
E	Total Net Revenue (actual)	-	1200.00	8.00	8.00	160.00	20.00	25.00	150.00	1571.00
F	Sub-lessees' Revenue Share % with Northstop	-	-	25%	25%	2.5%	15%	20%	10%	-
G	RevShare Amount paid by Sub-lessees to Northstop	E*F	-	2.00	2.00	4.00	3.00	5.00	15.00	31.00
H	Total Net Revenue (shown by Northstop in statement)	Part A + G								1,031.00
J	Revenue Share paid by Northstop to Maxima by 6%	H*6%								61.86
K	Revenue Share that should have been paid to Maxima	E*6%								94.26
L	Loss incurred by Maxima	K - J								32.40

The table above depicts what Maxima actually received as compared to what it should have received.

but delivered to the customers' homes. In addition to the ₹11 crores of sales, Northstop earns another ₹1 crore per month from the 1000 square feet of floor space on hire and other income from hire of hoardings, billboards, etc. within the store.

At the end of the financial year, after reconciling its accounts, Northstop sends a statement to Maxima Developers that the RevShare based rent has been computed as ₹61.86 lakhs per month (6% of ₹1031 lakhs average monthly Net Revenue) and since Northstop has already paid ₹55 lakhs as MG during each month of the year, Northstop has to pay a balance of ₹6.86 lakhs per month to Maxima. Within a week of sending the statement, Northstop delivers a cheque of ₹82.32 lakhs (6.86 x 12) at Centramall's centre management office.

When Mr Gupta, the owner of Maxima, hears about this, he is thrilled. He has received a bonus of ₹82.32 lakhs, which is 1.5 month's MG rent. It is almost like receiving rent for 13.5 months in a year comprising only 12 months. There is a small celebration and Mr Gupta takes out the entire centre management for drinks and dinner to a 4-star hotel. Mr Gupta also takes Anil Medhraj along and thanks him for getting such a wonderful anchor tenant into Centramall.

So, if this story has such a happy ending for all the parties, why does it have "scam" in the title? Because Maxima and Mr Gupta have been shortchanged to the tune of ₹388.80 lakhs (₹32.40 lakhs per month). Now, how did I figure that out?

As per the definition of Net Revenue given at the beginning of this article, the actual average monthly Net Revenue from the Leased Premises is ₹1571 lakhs and not ₹1031 lakhs as claimed by Northstop in their statement. Therefore, the RevShare rent should be ₹94.26 lakhs (6 per cent of ₹1571 lakhs) and not ₹61.86 lakhs (6 per cent of ₹1031 lakhs) as claimed by Northstop.

How did I arrive at ₹1571 lakhs – it's actually quite simple – ₹1100 lakhs net sales of Northstop + ₹160 lakhs of Kanishka + ₹150 lakhs of Home City + ₹25 lakhs of Deepika's Secret + ₹20 lakhs of Eye Express + ₹8 lakhs of Smartcuts + ₹8 lakhs of Coffeebits + ₹100 lakhs of other income earned by Northstop from the space on hire.

But how did Northstop calculate ₹1031 lakhs? That's actually also quite simple – from the ₹1100 lakhs, they first deducted ₹50 lakhs of redemptions because "they didn't receive money against this". Then they deducted another ₹50 lakhs worth of home deliveries made against telephone orders, because "the customer did not come to the store, so why should the landlord get any benefit from this?" So, Northstop's own sales as reported in their statement was just ₹1000 lakhs. To this, they added the ₹31 lakhs that they received as RevShare from their sub-lessees and concessionaires (₹4 lakhs from Kanishka + ₹15 lakhs from Home

City + ₹5 lakhs from Deepika's Secret + ₹3 lakhs from Eye Express + ₹2 lakhs from Smartcuts + ₹2 lakhs from Coffeebits) as Northstop felt that this is the revenue that Northstop is "supposed to" share with Maxima. In addition, Northstop did not add the ₹100 lakhs it earned from space on hire as this was "a tactical part of their negotiation with brands" who they deal with.

Due to this innovative accounting, Northstop paid Maxima only ₹1.86 lakhs out of ₹231 lakhs income that they earned (Rs100 lakhs from space on hire, ₹100 lakhs from redemptions and home deliveries and ₹31 lakhs revenue share from sub-licensees). Hmmm!

And if Maxima only received ₹61.86 lakhs per month from premises that had a net revenue of ₹1571 lakhs, then in actual effect, Maxima only got 3.94 per cent revenue share and not 6 per cent that it had signed for.

So, who is wrong and who is right? That's for Mr Gupta to decide, isn't it? As far as Anil Medhraj is concerned, he gets his brokerage on the MG amount, so he could be least bothered about how much revenue share the landlord is really getting. Best case, if Northstop was honest and had paid Maxima ₹471.12 lakhs (₹39.26 lakhs x 12, in which ₹39.26 lakhs is the difference between the actual revenue share amount of ₹94.26 lakhs that Northstop should have paid and the MG amount of ₹55 lakhs), Mr Gupta might have taken him to the Four Seasons Hotel for dinner instead of some "cheap" 4-star hotel. Not worth Anil Medhraj spending so much time on – after all, in all this time, Medhraj can do another deal.

I have started discovering that this is the way many anchor tenants have been operating in India – like the case example in this article. This may actually include a couple of listed companies – but in the world of Satyam and 2G, does being listed on a stock exchange make anyone less crooked?

Most Indian landlords (or shopping centre developers / owners) don't have a clue that this is going on. They don't even suspect anything, as they don't understand all these complex calculations. Like Mr Gupta in this story, they are happy to receive anything more than the minimum guaranteed rent.

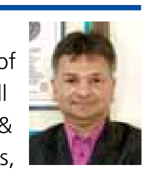
Like the Kalmadi CWG scam, the RevShare scam is multi-faceted. It is not just restricted to innovative summation of net revenue like the Northstop case example. There are many other "methods" being used by retailers to report lesser revenues to landlords.

Well managed shopping centres collect daily sales figures (mostly verbally) from store managers. Many of them have discovered that the sales/revenue number in the Monthly Sales Report (which mostly comes from the HO) sent by retailers is 25-40 per cent lesser than the sum of 30 or 31 days' daily sales numbers. Granted that the daily number usually is VAT inclusive and the monthly number VAT exclusive, but surely the difference cannot be 25-40 per cent, as VAT has not reached such high proportions in any Indian state(yet)!

In conference after conference, forum after forum, we are debating the retailers' point of view that rents in India are too high. For a change, why don't we debate this issue of how revenue share should be calculated and whether income from "space on hire" – within premises built and leased by the developer – should be part of the revenue they share with developers? Or, for that matter, why don't we debate why these revenue share paying "modern" retailers are doing less than half or one-third business per square foot when compared with traditional retailers like The Chennai Silks or RmKV?

I am off to the Four Seasons Hotel with Mr Gupta. After all, I better fill my stomach just in case I have to go on a fast at Ramlila Ground or Jantar Mantar. Adieu till next time. ●

About the author:



Amit Bagaria is chairman of Asipac, India's leading mall development consultants & managers and Men & Boys, the world's largest chain of retail stores for men's cosmetics, skincare, hair care and grooming products.

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