

**Retail Management**  
**Chapter 8**  
**RETAIL SITE LOCATION**  
**Lecturer: Michaella DeLeon Castillo, DBA**

**RETAIL MANAGEMENT – LECTURE 8**

**CHAPTER 8 – RETAIL SITE LOCATION**

**Overview**

It goes over the steps that retailers take when choosing store locations and negotiating leases. The first section of the chapter looks at the factors that retailers consider when deciding where to locate stores and how many to open in a given area. The chapter then goes over various methods for evaluating specific sites and estimating expected sales if and when a store is built there. Finally, the chapter examines the various terms that are negotiated when a retailer agrees to lease space for its business.

**Desired Learning Outcomes**

1. Discuss the factors that retailers take into account when deciding where to open their stores.
2. Explain what a store's trade area is, and how retailers determine it.
3. Describe the factors that retailers consider when choosing a location.
4. Explain how retailers expect new store locations to perform in terms of sales.
5. Explain how retailers can obtain information to help them evaluate potential store locations.
6. Examine the issues that arise when negotiating leases.

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**LESSON 1**

**RETAIL SITE LOCATIONS**

**Learning Objective 1 – Evaluating Specific Areas for Locations**

Countries, areas within a country such as a province in France or a state in the United States, specific cities, or areas within cities are all areas that retailers consider when deciding where to open stores. Because consumers tend to shop within an MSA, and media coverage and demographic data for analyzing location opportunities are often organized by MSA, retailers in the United States often focus their analysis on a metropolitan statistical area (MSA). Examine the issues that arise when negotiating leases.

An MSA is defined as a core urban area with a population of more than 50,000 people, as well as neighboring communities with a high level of economic and social integration with the core community. Many people in an MSA, for example, commute to work in the city center but live in the suburbs. An MSA can be made up of one or more counties and is usually named after the MSA's largest city. For example, the Cincinnati-Middletown MSA has a population of 2,155,137 people and is made up of 15 counties (3 in Indiana, 7 in Kentucky, and 5 in Ohio); the Missoula, Montana, MSA has a population of 107,320 people and is made up of one county. A micropolitan statistical area (MiSA) is a smaller unit of analysis, with a core urban area of only 10,000 people. The best locations for stores are those that provide a retailer with the most long-term profits. When evaluating an area, consider the following factors that affect the long-term profit generated by stores: (1) economic conditions, (2) competition, (3) the strategic fit of the area's population with the retailer's target market, and (4) the costs of operating stores.

Economic Conditions

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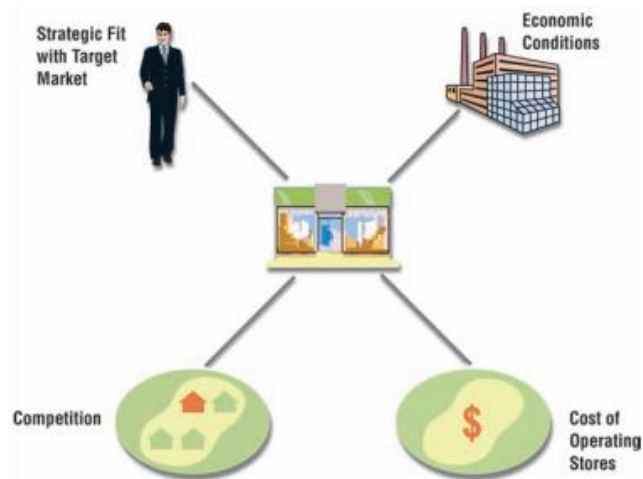
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Because locations entail a long-term investment of resources, it's critical to look at a region's population and employment levels and growth. A large, fully employed population translates to increased purchasing power and retail sales.

However, population and employment growth are insufficient to ensure a healthy retail environment in the future. Analysts at retail locations must determine how long such growth will continue and how it will affect demand for goods sold in stores.

#### EXHIBIT 8-1

Factors Affecting the Demand for a Retail or Trade Area



#### Competition

The level of competition in a given area has a significant impact on the demand for a retailer's goods. Walmart's early success was built on a location strategy that saw the company open stores in small towns with little competition. It provided consumers in small towns with high-quality goods at low prices. Previously, rural shoppers had to choose between shopping in small stores with limited selections or driving to larger cities.

#### Strategic Fit

The level of population, growth, and competition do not tell the whole story. Consumers in the retailer's target market—those who are drawn to the retailer's offerings and interested in visiting its stores—must be present in the area. As a result, the demographic and lifestyle

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profile of the area must be appropriate. The size and composition of a community's households can have a significant impact on its success. Finally, depending on the target market(s) that a retailer is pursuing, lifestyle characteristics of the population may be relevant.

#### **Operating Costs**

The proximity of the area under consideration to other areas where the retailer operates stores has an impact on operating costs. If a store is close to other stores and the retailer's distribution centers, for example, the cost of shipping merchandise to the store is lower, as is the cost and time spent by the district manager supervising the stores' operations. The legal and regulatory environment at the local and state levels can have a significant impact on operating costs. Some retailers are hesitant to open stores in California because they believe the state and local governments, the political process of voter-initiated referendums, and a legal environment that encourages class-action lawsuits are all hostile to business.

#### **Learning Objective 2 - Number of Stores in An Area**

After deciding on a location for its stores, a retailer must then decide how many stores to open in that area. At first glance, it may appear that a retailer should select the best location in each MSA, but larger MSAs clearly have the capacity to support more stores than smaller MSAs. As a result, it may be more cost-effective to locate several stores in one MSA while none in others. Even the largest MSAs, however, have a limit on how many stores they can operate. When deciding how many stores to open in a given area, retailers must weigh the benefits of lower operating costs versus the risk of sales cannibalization from having multiple locations.

#### **Economies of Scale from Multiple Stores**

Because promotion and distribution economies of scale can be achieved, most retail chains open multiple stores in a given area. The total promotional costs for a retailer are the same whether they advertise 20 stores in a given area or just one. To justify the cost of constructing a new distribution center, multiple stores in a given area are required. As a result, retailers like Walmart only expand into areas where they already have a distribution center to support their stores. Kohl's

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opened 14 stores in Jacksonville and Orlando on the same day when it entered the Florida market. Opening multiple stores in a given area can both increase sales and lower costs. For example, while the United States has 6,100 Dunkin' Donuts, 2,100 are concentrated in the Northeast. Only about 40 of them make their own donuts. The rest receive deliveries from centralized bakeries twice a day. The donuts are then frosted and filled on the spot in the stores. Having so many stores in one location also makes promotional activities easier. For example, placing an ad in the Boston Globe for one store or 2,000 costs the same. Dunkin' Donuts is synonymous with donuts in the Northeast. Customers are familiar with the purple and orange stores and expect to see them everywhere. Finally, the management team can exert more control over a regional market because managers can easily visit stores and assess competitive situations.

#### **Cannibalization**

Although retailers benefit from scale economies when they open multiple locations in a given area, they also suffer diminishing returns when they open too many additional stores. Assume that the first four specialty store retailers that open in an MSA each generate \$2 million in sales. Customers consider patronizing only the store closest to them because they are located so far apart, and there is no cannibalism. The retailer expects a net sales increase of \$2 million in the area when it opens a fifth store near one of the existing stores; the new store should generate the same level of sales as the four existing stores.

Instead, sales increase by only \$1.5 million because sales at the closest existing store drop to \$1.7 million, and sales at the new store are only \$1.8 million because it is only the fifth best in the area. As a result, the new store only contributes \$1.5 million in sales because it cannibalizes sales from the closest store. When it comes to franchise retail operations, the franchisor and franchisee have different goals, which can lead to disagreements over the number of locations in a given area. Because the franchisor earns a royalty based on total store sales, it is interested in maximizing the sales of all stores. The franchisee is only concerned with the store's sales and profits (s). As a result, the franchisor is less concerned about cannibalism than the franchisee. Most franchise agreements give franchisees an exclusive territory to protect them from another franchisee cannibalizing their sales. This helps to reduce conflict.

### **Learning Objective 3 – Evaluating A Site for Locating A Retail Store**

After deciding to open stores in a specific area, the retailer must evaluate and choose a specific location. Retailers consider three factors when making this decision: (1) the site's characteristics, (2) the trading area for a store at the site, and (3) the estimated potential sales that a store at the site can generate. In most cases, the first two sets of factors are taken into account during the initial screening of potential sites. The third factor, the methods used to forecast store sales, can entail a more complex analytical approach. The following sections go over each of these factors in detail.

#### **Site Characteristics**

(1) the traffic flow past the site and accessibility to the site, (2) the characteristics of the location, and (3) the costs associated with locating at the site are some characteristics of a site that affect store sales and are thus considered in selecting a site.

#### **Traffic Flow and Accessibility**

The number of vehicles and pedestrians passing by the site, or traffic flow, is one of the most important factors affecting store sales. When there is more traffic, more people are likely to come in and shop at the store. As a result, retailers frequently use traffic count measures to determine the attractiveness of a website. Traffic counts are especially important for retailers who sell items and services that are purchased on the spur of the moment or on a regular basis.

More traffic flow isn't always better; rather, it's a matter of finding the right balance. The site should have a significant number of cars per day, but not so many that access to the store is hampered by traffic congestion. The retailer can conduct site visits or hire a specialized firm to conduct the study to determine the level of vehicular traffic. However, the number of vehicles passing through the site may not tell the whole story. The data may, for example, need to be adjusted for the time of day. During the rest of the day, when most shopping is done, areas that are congested during rush hour may have a good traffic flow.

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**The ease with which customers can enter and exit the site, which can be just as important as traffic flow, is referred to as accessibility. Sites near major highways, on less congested highways, and on streets with traffic lights and lanes that allow turns into the site have better accessibility.**

Natural and man-made barriers, such as rivers and mountains, as well as railroad tracks, divided or limited-access highways, and parks, can all limit accessibility. The impact of these barriers on a specific site is primarily determined by whether the merchandise or services will entice customers to cross the barrier. A supermarket on one side of a divided highway with no convenient crossover point, for example, will only appeal to motorists traveling in one direction.

#### **Location Characteristics**

Some factors associated with specific locations that retailers consider when evaluating a site are (1) parking, (2) store visibility, and (3) adjacent retailers.

#### **Parking**

For evaluating a shopping center and a specific site within the center, the quantity and quality of parking facilities are critical. On the one hand, customers will be discouraged from visiting the site and store if there aren't enough spaces or if the spaces are too far away.

Retailers must monitor the mall at different times of the day, week, and season. They must also consider employee parking, the percentage of shoppers who drive, parking by non-shoppers, and the average length of a shopping trip.

The relative congestion of the area is closely related to the amount of available parking facilities but extends into the shopping center itself. Congestion is defined as an excess of traffic that causes customer delays. For customers, there is an ideal level of congestion. Too much traffic slows down shopping, irritates customers, and discourages sales. A high level of activity in a shopping center, on the other hand, creates excitement and can boost sales.

#### **Visibility**

Customers' ability to see the store from the street is referred to as visibility. Although good visibility is less important for stores with a strong and loyal customer base, most retailers still want

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a clear, unobstructed view of their store. Good visibility from the road is especially important in areas with a high transient population, such as a tourist destination or a large city.

#### **Adjacent Tenants**

Locations with both complementary and competing retailers adjacent to each other have the potential to increase traffic. Complementary retailers serve the same market segment as competitors, but they sell different, non-competing merchandise.

#### **Restrictions and Costs**

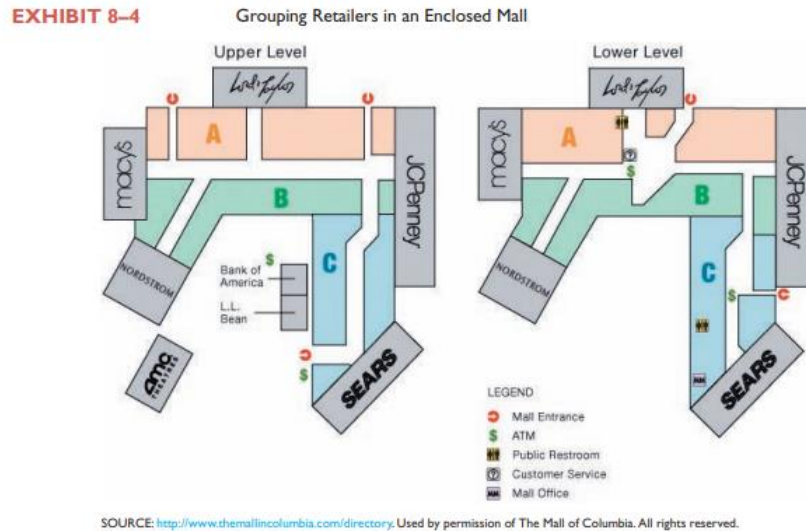
As we'll see later in this chapter, retailers can put restrictions in their lease agreements on the types of tenants that are allowed in a shopping center. Some of these constraints may make a shopping center more appealing to a retailer. A specialty men's apparel retailer, for example, may prefer a lease agreement that prevents other men's specialty apparel retailers from opening in the same shopping center. A florist in a strip mall may stipulate that it can be released from its lease if the grocery anchor tenant vacates the center.

#### **Locations within a Shopping Center**

The quality of a shopping center's location has an impact on both sales and occupancy costs, with the better locations having higher occupancy costs. The locations closest to the supermarket in a strip shopping center are more expensive because they attract more foot traffic. As a result, a flower shop or sandwich shop that might appeal to impulse buyers should be located near the supermarket. A shoe repair shop, on the other hand, which does not cater to impulse shoppers, could be located in a less-trafficked area further away from the supermarket because customers in need of this service will seek it out. It is, in other words, a destination store.

Another factor to consider is where to find stores that cater to similar target markets. Customers want to shop where they can find a diverse selection of products. Both stores that sell complementary merchandise and those that compete directly with one another are affected by the cumulative attraction principle.

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**Learning Objective 4 - Trade Area Characteristics**

**Trade Area Definition**

A trade area is a contiguous geographic area in which a store's sales and customers are concentrated. As shown in Exhibit 8-5, trade areas can be divided into three zones. The trade area zones for a shopping center located at the red square are shown in the exhibit: the 5-minute drive-time zone (light brown), the 10-minute zone (blue), and the 15-minute zone (red) (green).

The primary trading area is the geographic area from which 50 to 70 percent of a shopping center's or store's customers come. The secondary trading area is a geographic area that generates about 20 to 30 percent of the site's customers and is of secondary importance in terms of customer sales. The remaining customers who shop at the site but come from widely dispersed areas are included in the tertiary trading area or fringe (the outermost area).

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#### Factors Affecting the Size of the Trade Area

A parasite store is one that does not generate its own traffic and relies on the dominant retailer in the shopping center or retail area to determine its trade area. People tend to stop at the dry cleaner on their way to or from Walmart and other stores, so a collocated dry cleaner would be a parasite store to a Walmart store. Walmart and other local businesses provide the majority of its revenue. Walmart's dominance, according to some retail experts, can be a destabilizing force for competition in a market.

#### Measuring the Trade Area for a Retail Site

Customer spotting allows retailers to determine the trade area for their existing stores. Customer spotting is the process of locating and displaying the residences of a store's customers on a map, in relation to the store's location. Customers' addresses are usually obtained by asking them, recording information from a check or an Internet channel purchase, or collecting data from customer loyalty programs. Customer spotting data can be processed in two ways: manually plotting each customer's location on a map or using a geographic information system.

#### Sources of Information about the Trade Area

A retailer needs information about both consumers and competitors in the site's trade area to further analyze the attractiveness of a potential store site. (1) Data published by the U.S. Census Bureau and (2) data published by the World Bank are two widely used sources of information about the nature of consumers in a trade area. (1) data from geographic information systems, provided by several commercial firms, and (2) data from the Census Bureau, based on the United States' Decennial Census.

**Geographic Information System Suppliers** A **geographic information system (GIS)** A GIS is a set of hardware and software for storing, retrieving, mapping, and analyzing geographic data; it also includes the people who run the system and the data that goes into it. The primary characteristic of GIS data is that it is associated with a coordinate system (latitude and longitude)

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that refers to a specific location on Earth. The systems' data includes spatial features like rivers and roads, as well as descriptive information about the spatial features, such as the street address and the characteristics of the household at the address.

#### **Competition in the Trade Area**

Retailers need to know about the amount and type of competition in their trade area, in addition to information about the residents. Although GIS vendors provide data on the locations of competing retailers, this information can also be obtained from other sources. Most retailer Web sites, for example, list not only all current store locations but also future ones.

#### **Learning Objective 5 – Estimating Potential Sales for A Store Site**

Three approaches for using information about the trade area to estimate the potential sales for a store at the location are (1) the Huff gravity model, (2) regression analysis, and (3) the analog method.

#### **Huff Gravity Model**

The Huff gravity model<sup>14</sup> for estimating retail store sales is based on the concept of gravity: Customers are drawn to a store location in the same way that Newton's falling apple was drawn to the Earth. The strength of the attraction in this model is determined by two factors: the store's size (larger stores have more pulling power) and the time it takes to travel to the store (stores that take more time to get to have less pulling power).

#### **Regression Analysis**

The regression analysis method is based on the assumption that the same factors that affect sales in existing stores in a chain will have the same effect on stores at new locations under consideration. The retailer uses a technique called multiple regression to estimate a statistical model that predicts sales at existing store locations when using this approach. The technique can take into account the effects of a variety of factors discussed in this chapter, such as site

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characteristics like visibility and access, as well as trade area characteristics like demographics and lifestyle segments represented.

**Analog Approach**

The majority of retailers rent their storefronts. Despite the benefits of owning a store location (such as stable mortgage payments and freedom from lease covenants), most retailers do not want to invest in real estate. Furthermore, the majority of the best locations, such as those in shopping malls, are only available for lease. Percentage and fixed-rate leases are the two most common types of leases.

**Learning Objective 6 – Negotiating a Lease**

**Types of Leases**

The majority of retailers rent their storefronts. Despite the benefits of owning a store location (such as stable mortgage payments and freedom from lease covenants), most retailers do not want to invest in real estate. Furthermore, the majority of the best locations, such as those in shopping malls, are only available for lease. Percentage and fixed-rate leases are the two most common types of leases.

**Percentage Leases** Although each type of lease has many variations, the most common is a percentage lease, in which the rent is calculated as a percentage of sales. Retailers typically pay a maintenance fee based on a percentage of their leased space's square footage in addition to the percentage of sales. The majority of shopping malls use a percentage lease. Because retail leases typically last 5 to 10 years, rent increases (or decreases) in tandem with sales and inflation appear to be fair to both parties.

A percentage lease with a maximum payment is one in which the lessor, or landlord, receives a percentage of sales up to a certain amount. This type of lease encourages retailers to

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perform well by allowing them to keep rent constant above a certain sales threshold. A similar variation, a percentage lease with a specified minimum, requires the retailer to pay a minimum rent regardless of sales volume.

A sliding scale lease is another type of percentage lease, in which the percentage of sales paid as rent decreases as sales increase.

**Fixed-Rate Leases** A fixed-rate lease is the second most common type of lease, which is most commonly used by community and neighborhood centers. Over the course of the lease, a retailer pays a set amount per month. The retailer and landlord know exactly how much rent will be paid with a fixed-rate lease, but as previously stated, this type of lease does not appear to be as popular as the various types of percentage leases. The graduated lease is a variation of the fixed-rate lease in which rent increases by a fixed amount over a set period of time.

A percentage or fixed-rate lease can be used with a maintenance-increase-recoupment lease. If the cost of insurance, property taxes, or utility bills exceeds a certain threshold, the landlord can raise the rent.

#### **Terms of the Lease**

Although leases are formal agreements, they can be modified to reflect the retailer's relative power and specific needs. Because the lessor (the property owner) develops the basic format of most leases, the terms of the lease may be skewed in favor of the lessor. As a result, it is the lessee's responsibility to ensure that the lease reflects the lessee's needs (in this case, the retailer).

**Cotenancy Clause** A cotenancy clause can be found in some retail leases. Some cotenancy clauses specify a percentage of a shopping center that must be leased, while others name specific retailers or types of retailers that must remain open. If these conditions are not met, the retailers who have cotenancy clauses may demand rent reductions or may be forced to vacate the premises. If the tenants specified in the cotenancy clause either leave the center or fail to move in, a retailer who has not yet moved in can back out.

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**Prohibited-Use Clause** The landlord is prohibited from leasing to certain types of tenants under a prohibited-use clause. Many retailers don't want the landlord to lease space to businesses like a bowling alley, skating rink, meeting hall, dentist, or real estate office that take up parking spaces but don't bring in customers. Retailers may also want to limit the use of space by businesses that could detract from the shopping center's overall image.

Bars, pool halls, game parlors, off-track betting establishments, massage parlors, and pornography retailers are frequently mentioned in prohibited-use clauses.

**Exclusive-Use Clause** An **exclusive-use clause** prohibits the landlord from leasing to competing-products-selling retailers. Some retailers are also picky about how their storefront looks. For example, a women's specialty store may require floor-to-ceiling glass in order to maximize window displays and improve customers' visibility into the store. Other retailers believe it is critical that nothing in the parking lot obscures the store's view from the street, so they stipulate that the landlord may not place any outparcels there.

An outparcel is a structure (such as a bank or a McDonald's) or a kiosk (such as an automated teller machine) that is located in a shopping center's parking lot but is not physically connected to the center.

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## INTERNET EXERCISE

- a. Visit [http://www.esri.com.com/library/fliers/pdfs/tapestry\\_segmentation.pdf](http://www.esri.com.com/library/fliers/pdfs/tapestry_segmentation.pdf), and write down the five segments you'd expect to see in your zip code. Go to [www.gis.com/index.html](http://www.gis.com/index.html), then enter your zip code. Compare the segments found in your zip code to the ones you predicted. Are they comparable or dissimilar?
- b. INTERNET EXERCISE Click on "Demo: What is GIS?" on the Esri Geographical Information Systems home page, [www.gis.com/index.html](http://www.gis.com/index.html). Explain how retailers can use GIS to make better decisions after watching the three-minute video.

## Quiz – Chapter 8

### Identification

1.	A large, well-known retail operation located in a shopping center or Internet mall and serving as an attracting force for consumers to the center.
2.	Legal restrictions describing the size and type of building, signs, type of parking lot, and so on that can be used at a particular location.
3.	The traditional downtown business area of a city or town.
4.	The common facilities maintenance that a shopping center management is responsible for, such as the parking area, providing security, parking lot lighting, outdoor signage for the center, advertising, and special events to attract consumers.
5.	A type of shopping situation whereby consumers have a general idea about the type of product or service they want, but they do not have a well-developed preference for a brand or model.
6.	When consumers are primarily concerned with minimizing their effort to get the product or service they want.

7.	A retail store in which the merchandise, selection, presentation, pricing, or other unique feature acts as a magnet for customers.
8.	A retail location that is not connected to other retailers.
9.	A process in which old buildings are torn down or restored to create new offices, housing developments, and retailers.
10.	Typically a high-density urban area consisting of apartment buildings populated primarily by ethnic groups.
11.	A shopping center with an outdoor traditional streetscape layout with sit-down restaurants and a conglomeration of specialty retailers.
12.	The central business district located in the traditional shopping area of smaller towns, or a secondary business district in a suburb or within a larger city.
13.	Small, temporary selling spaces typically located in the walkways of enclosed malls, airports, train stations, or office building lobbies.
14.	Development that combines several uses in one complex—for example, shopping center, office tower, hotel, residential complex, civic center, and convention center.
15.	A shopping center that includes a supermarket, drugstore, home improvement center, or variety store. Neighborhood centers often include small stores, such as apparel, shoe, camera, and other shopping goods stores.
16.	A combination of mall, lifestyle, and power center components in a unified, open-air layout.
17.	Off-price retailer owned by a manufacturer or a department or specialty store chain.
18.	A building or kiosk that is in the parking lot of a shopping center but isn't physically attached to a shopping center.
19.	Stores in temporary locations that focus on new products or a limited group of products.
20.	Shopping center that is dominated by several large anchors, including discount stores (Target), off-price stores (Marshalls), warehouse clubs (Costco), or category specialists such as Home Depot, Office Depot, Circuit City, Sports Authority, Best Buy, and Toys "R" Us.
21.	Shopping malls less than 1 million square feet.
22.	A group of retail and other commercial establishments that is planned, developed, owned, and managed as a single property.
23.	Enclosed, climate-controlled, lighted shopping centers with retail stores on one or both sides of an enclosed walkway.
24.	Shopping experiences when consumers know what they want and will not accept a substitute.
25.	A shopping center that usually has parking directly in front of the stores and does not have enclosed walkways linking the stores.

26.	Shopping center that is similar to a regional center, but because of its larger size, it has more anchors and a deeper selection of merchandise, and it draws from a larger population base.
27.	A shopping center that typically employs a unifying theme that is carried out by the individual shops in their architectural design and, to an extent, their merchandise.
28.	A geographic sector that contains potential customers for a particular retailer or shopping center.
29.	The regulation of the construction and use of buildings in certain areas of a municipality.

**Answer Key**

1. anchor store
2. building codes
3. central business district (CBD)
4. common area maintenance (CAM)
5. comparison shopping situation
6. convenience shopping situation
7. destination store
8. freestanding site
9. gentrification
10. inner city
11. lifestyle center
12. Main Street
13. merchandise kiosk
14. mixed-use development (MXD)
15. neighborhood strip shopping center
16. omnicenter
17. outlet center
18. outparcel
19. pop-up store
20. power center

21. regional mall
22. shopping center
23. shopping mall
24. specialty shopping
25. strip shopping center
26. superregional mall
27. theme/festival center
28. trade area
29. zoning