Global Property Market Review

European Distribution and Warehouse Markets

Winter 2008

Internet Retailing

Opportunities and Challenges for the UK's Distribution Property Markets

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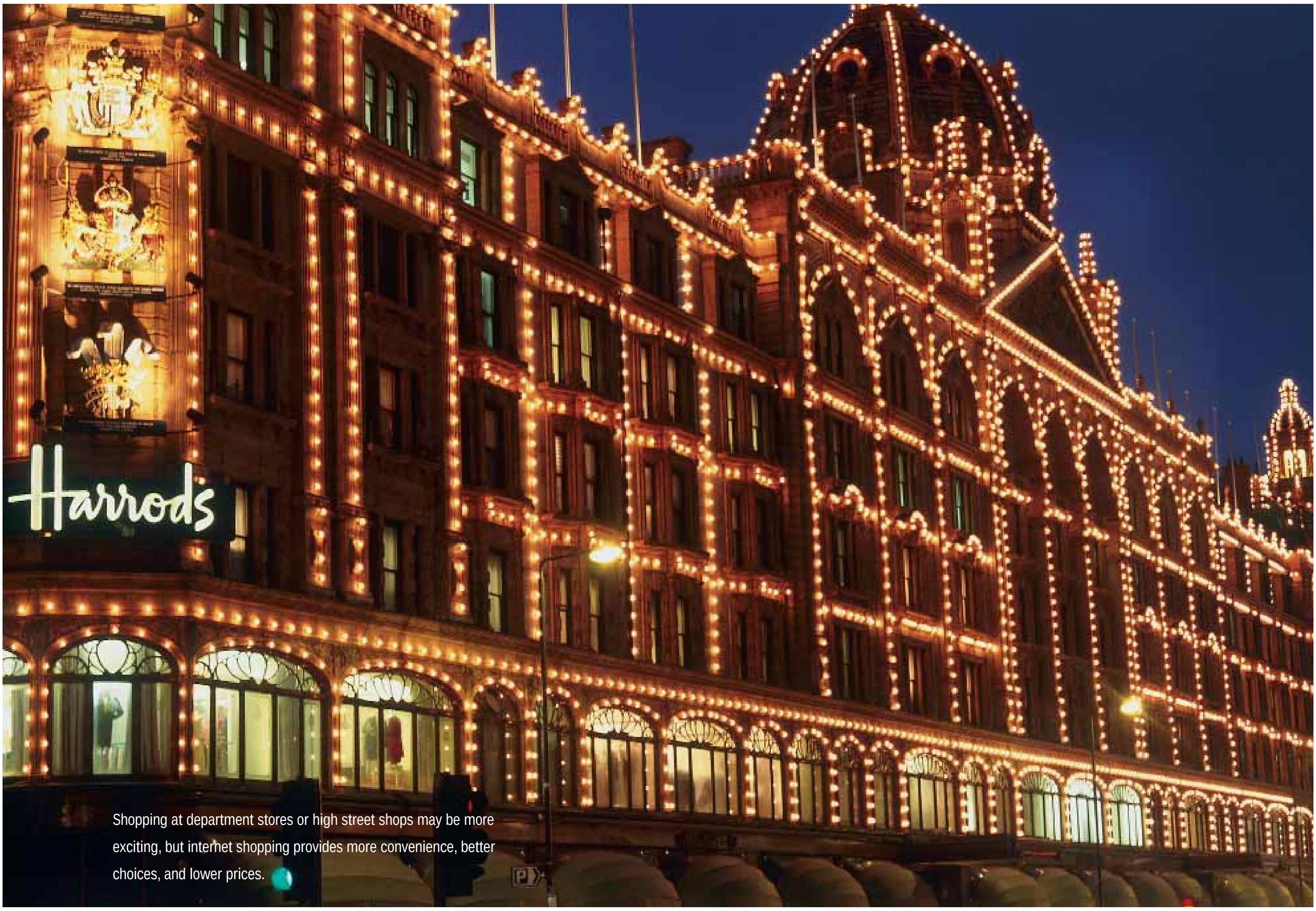
Foreword

Internet retailing in the UK is soaring. As it continues to grow, so will its warehouse space requirements.

- Online retail sales in the UK grew 370% during 2002-06 and increased their penetration of the retailing industry to 11% in 2006 from just 3% in 2002.
- Internet retailing is a boon for the UK's warehouse/distribution property markets, in as much as internet sales enable retailers to substitute low-cost shelf space in distribution facilities for high-cost shelf space in traditional retail stores.
- Some of the largest players in the UK internet retailing market are the "bricks and mortar" store-based retailers, including major supermarket chains, multi-merchandising retailers, and specialty retailers.
- Internet retailers have discovered that the distribution systems needed to support home deliveries differ greatly from those used by traditional retailers to transport merchandise from warehouses to store networks.
- Internet retailers generally rely on one of three alternative delivery models — in-store picking, direct delivery to the customer from either a central distribution centre or a regional distribution centre, or outsourced deliveries.
- The huge multi-merchandisers with enormous product ranges typically rely on a regional distribution strategy with dedicated carriers or operations designed to deliver many different types of goods.
- The multi-merchandisers have found that it is inefficient to operate all home deliveries from one or even a few massive warehouses. Many have established home delivery platforms or transshipment facilities in major urban areas where lorry loads are disassembled into smaller vans and lorries for direct delivery to homes and businesses.
- Smaller, niche internet retailers typically opt for a national distribution strategy. The size of the distribution facility depends critically on the volume of goods sold.
- Sorting centres and delivery platforms are also required by the postal and parcel carriers and delivery specialists used to deliver internet purchases to their final destinations.

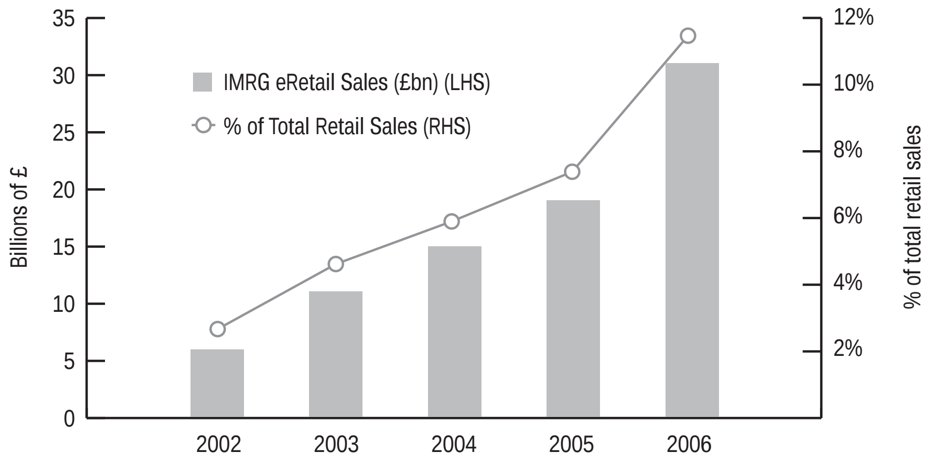


Shopping at department stores or high street shops may be more exciting, but internet shopping provides more convenience, better choices, and lower prices.

Clicks versus bricks and mortar

Internet retailing — or e-tailing, as it is sometimes called — is changing the rules governing a retailer's success or failure. Market catchment, for example, has expanded beyond the one-mile, two mile, or ten-mile radii centred on particular store locations to encompass the entire nation, or even globe. Because internet retailers operate independently of store networks, they never have to worry about where to locate new stores or how many stores to open or close. True, price points and customer service still do matter to e-tailers, but their concept of customer service has taken on new meanings.

Exhibit 1
Online retail spending in the UK — 2002-06



Sources: IMRG and Experian

Internet retailing — or e-tailing, as it is sometimes called — is changing the rules governing a retailer's success or failure.

In the context of internet retailing, customer service has little to do with the helpfulness or marketing savvy of the sales force. Instead, it centres on how quickly and reliably merchandise purchased in cyberspace will be delivered to the customers and, to a lesser extent, on merchandise-return strategies. How best to deliver such merchandise depends partly on the size and bulkiness of the shipments and partly on how quickly customers want the goods to be delivered. This report addresses two key questions: (a) how are internet retailers handling their deliveries, and (b) how have their delivery strategies affected their warehousing requirements.

In principle, internet retailing should bolster demand for warehouse/distribution floorspace. Web-based sales enable retailers to substitute low-cost shelf space in distribution facilities for high-cost shelf space in traditional retail stores, located either along high streets or in retail warehouses and retail parks. Similarly, direct sales by manufacturers, another new growth "industry" benefiting from the internet, should have essentially the same impact on the warehouse property markets as internet retailing does.

Whilst internet retailing will be a boon for the UK's distribution property markets, its impact tends to be highly variable. In practice, many considerations come into play, including the size of the retailer and its retail network, the type of goods sold, the value of the average purchase and the location of its customers. In any event, internet retailing is not only here to stay, but will continue to expand its penetration into retail sales; as it does so, its warehouse space requirements will also grow.

Internet Retailing — Soaring

The retail world has undergone a revolution during the past decade. Formerly, a retailer's success was determined by the type of merchandise that it carried, the number of stores that it controlled, the locations of those stores, and the efficiency of its supply chains and distribution networks.

Today, its success also rests on the number of channels through which it can reach its customers. Multi-channel selling has become so important to the retail markets that entirely new industries and businesses have sprung into operation in just a few short years.

One of the UK's most successful new sales channels is internet retailing. It has enjoyed phenomenal growth in recent years and shows no sign of slowing down. The first secure online purchase in the UK was completed in April 1995. During the past four years alone, online retail sales have soared 370% to £30bn in 2006, whilst the volume of total retail sales grew just 15% to £250bn (see Exhibit 1). As a result, online retailing has increased its penetration of the retail industry to 11% in 2006 from just 3% in 2002.

Of this £30bn in online sales, Forrester Research estimates that £19.5bn was spent on physical goods — that is, excluding such products as travel, theatre tickets and digital downloads. Those online sales of £19.5bn included a wide array of products — including food and beverages, clothing and footwear, furniture, appliances, CDs and DVDs. Estimates of spending by product group from Forrester Research put online spending on clothing and footwear as the largest category in 2006, followed closely by groceries and then household goods, furniture, and appliances (see Exhibit 2).

> Multi-channel selling has become so important to the retail markets that entirely new industries and businesses have sprung into operation in just a few short years.

Who are the online retailers?

Most UK retailers use the internet as one more sales channel to reach or broaden their customer base (see Exhibit 3). Some of the largest players in the UK e-tailing market are "bricks and mortar" store-based retailers like major supermarket chains (Tesco, Sainsbury's, and Asda), multi-merchandising retailers (like Argos, Next, and Dixons), and more narrowly focused retailers specialising in particular product lines such as health and beauty products (Superdrug and Boots the Chemist) and books, CDs, and DVDs (Waterstone's, WH Smith, and HMV).

Other online retailers, however, are "pure" e-tailers. They have no "bricks and mortar" high-street presence at all, and all of their sales are booked through the internet channel. The largest such e-tailer, by far, is Amazon.co.uk, the UK subsidiary of the US internet retailing giant. Smaller businesses also sell in the UK and have seen significant growth in recent years in terms of volume, profile, and depth of offering.

A whole new industry has emerged to promote and facilitate online selling.

Some online retailers have evolved from the home shopping and catalogue industry. Companies like Boden and Littlewoods, for example, began with sales generated from catalogue purchases whilst significant proportions of their current sales are via the internet. Television shopping channels like QVC UK and Ideal World also offer products for sale on their websites as well as through conventional phone sales.

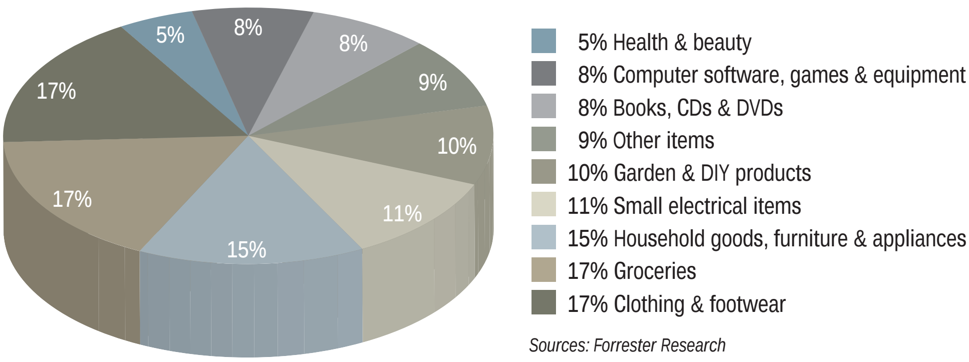
Manufacturers also sell directly to consumers via the internet. Until recently, Dell Computer had relied exclusively on the internet. (Dell, however, has begun recently to sell some of its products through traditional retailers.) Other manufacturers who sell direct to customers are electronics manufacturer, Apple, and beauty goods producer, Avon.

Individual entrepreneurs have also entered the fray. In 2005, private individuals completed an estimated 79 million transactions, accounting for some £2.8bn of online purchases. The vast majority of these sales were conducted as consumer-to-consumer transactions with individuals selling on auction websites and other sales forums like eBay and Amazon Marketplace.

However, some businesses are also using these sites as online sales channels. A recent survey of more than 1,000 businesses conducted by the Office of Fair Trading (OFT) found that 17% of the respondents had sold goods via an online auction, and that their main reasons for doing so were “to reach a wide audience” and “to sell off old stock”.

There are even consultancy firms that will handle the sale of businesses’ goods on online auction sites. For example, Vodafone outsourced selling and delivering its end-of-line and surplus stock on eBay to MarketWorks, an e-commerce specialist, and Royal Mail to considerable success. Vodafone is reported to have realised sales prices that on average were more than double what it received from other sales channels.

Exhibit 2
Online retail spending in the UK by product group - 2006



Sources: Forrester Research

Exhibit 3
Different types of retail businesses selling online

Type of business	Examples
Store-based retailers	Tesco, Comet, Next, PC World, Argos
Pure e-tailers	Amazon, ASOS.com, Play.com
Catalogue/home shopping retailers	Boden, Littlewoods
Manufacturers and wholesalers	Apple, Dell, Avon

Source: Gerald Eve

Who are the online buyers?

Within the UK, the community of online shoppers is estimated at about 25 million people, or about 70% of the total number of people who go online (In 2006, the UK's total population amounted to 61 million people). National Statistics reports that men are more likely to have purchased goods online with 50% reporting that they have made an online purchase, whilst only 38% of women reported the same.

Online spending varies with age and social grade. According to a recent survey by the British Council of Shopping Centres, people from 35-to-44 years of age were most likely to have shopped online. The recent OFT survey also reports that the average annual online spend was £763 per online consumer, with over half of online shoppers spending over £500 and almost a third spending over £1,000 per annum. Additionally, the OFT survey found that 42% of internet shoppers aged 25-54 years had spent £1,000 or more in the past 12 months, whereas only 18% of the over-55s and just 9% of the under-25s had spent that much.

Social grade was also found to have an impact on online spending. Of the respondents with managerial, administrative, or professional jobs, the OFT survey found that more than a third had spent £1,000 or more per annum. In contrast, of the respondents with skilled or unskilled labourer jobs or whose only income consists of state benefits, just 22% had spent £1,000 or more.

According to the OFT survey, the three main reasons why people prefer to shop online are convenience, choice, and lower prices:

- At the top of the list was convenience — 83% listed 24x7 access; 80%, ease of finding what they wanted; and 78%, comfort in shopping.
- Choice was also high on the list — 74% listed wider choice and the ability to compare prices, 38% reported that the internet was the only way to access certain items, and 42% said that they could access goods that were not available in the UK.
- Lower prices were also mentioned frequently — 72% of the respondents gave this as a key reason for shopping online.

The three main reasons why people prefer to shop online are convenience, choice, and lower prices.

Three alternative supply chain/delivery models

British e-tailers have discovered that the distribution systems needed to support home deliveries differ greatly from those used by traditional retailers to transport goods from warehouses to their store networks.

Three different supply chain models are being used today by etailers in the UK:

- Direct delivery to the customer from the store — or in-store picking.
- Direct delivery to the customer from either a central distribution centre or a regional distribution centre.
- Outsourced deliveries, where warehouse, distribution and delivery operations have been contracted to third party logistics providers (3PLs).

Each model is best suited to handle certain kinds of products and businesses, with each one having its own pluses and minuses (see Exhibit 4).

The delivery process itself is essentially the same for all three models. Carriers collect goods from the retailer's or 3PL's warehouse where goods have been picked, packed, and readied for delivery. From there, they are taken to a sorting centre for sorting into regional delivery areas. Next, they are either delivered directly to customers or taken to another delivery platform where the volume of parcels is split into smaller delivery lots.

In general, a retailer's optimal online sales distribution strategy is dictated by the scale of its operations, the size of its store network, its current warehousing network, and the type of product being moved. These factors will inform the supply chain model in terms of the number of facilities and their locations, sizes, and configuration.

In recent years, a broad range of home-delivery specialists has emerged along with the home delivery divisions of larger 3PLs.

Outsourcing

At present, the internet retailers in the UK have outsourced some or all of their deliveries of online sales merchandise to 3PLs. Indeed, we have been told that an online sales distribution network cannot be run effectively as a single-company operation unless it entails at least 50 million deliveries a year. Even the largest UK internet retailing operators currently send out nowhere near that many deliveries each year.

In recent years, a broad range of home-delivery specialists has emerged along with the home delivery divisions of larger 3PLs. For example, Wincanton, DHL Exel, and CEVA Logistics (formerly TNT Logistics) all offer home delivery services and have high-profile retail clients such as Comet, B&Q, Argos, Tesco, and Ilva. Other home delivery operators have emerged out of parcel delivery operations that now offer one/two-person delivery services.

Smaller items are generally posted or sent by parcel carrier, and where once the primary focus of parcel carriers was business-to-business delivery, business-to-customer services are offered today by a growing number of carriers. Services for home delivery have been deepening, with many carriers now offering ranges of timed delivery options such as next day, Saturday and evening delivery.

Some operators specialise in national and international coverage — which can be advantageous for e-tailers with a broad geographic customer base — whilst others are regional specialists, offering local market knowledge. Others specialise in e-fulfilment and/or home delivery (see Box 1).

Large retailers

In general, a retailer's optimal warehousing strategy will depend on its turnover, its customer base, and the scale and breadth of its operations. The large mass-merchandisers like Tesco and Argos, who offer enormous product ranges, usually rely on a regional distribution strategy with dedicated carriers or operations designed to deliver many different types of goods.

However, it is inefficient to generate all home deliveries from a single or even a few massive warehouses. To complement the large-scale stock handling required in the warehouses, the mass merchandisers often establish home delivery platforms or transhipment facilities in major urban areas where lorry loads are disassembled into smaller vans and truckloads for direct delivery to homes and businesses. Typically, these facilities are small — ie, less than 10,000 square feet (sq ft) — and provide little storage space, as they are designed to be "in-out" throughput operations.

Alternatively, some large e-tailers run a national distribution strategy for particular product types and assign a range of products for a particular product group to a single warehouse within a series of national distribution centres. Amazon, for example, has split its wide range of products into categories and stores and distributes the separate product categories from different national distribution centres located across the country.

Box 1: Home Delivery and E-fulfilment Specialist 3PLs

With the advent of online shopping, specialist home delivery and e-fulfilment firms have evolved to provide online retailers with the expertise, technology, and flexibility they need to manage their multi-channel sales and delivery strategies. The specialist firms have been highly successful because of their value proposition for the online retailers:

Expertise and technology platform: Handling the distribution of goods bought online is a relatively new field and is very different from the logistics supporting traditional warehouse-to-store networks. Outsourcing to a specialist 3PL may enable retailers to enter the online market more quickly.

No compromise to existing logistics platforms for delivery to stores: Mixing delivery models from a single platform can become very complex, and there is the potential for service interruptions not only to online customers but also to pre-existing store networks, impairing customer confidence and total sales. Outsourcing can minimise the interference new online distribution operations may have on existing logistics networks.

A scaleable solution: Growth at the initiation of an online retail presence is often very fast, and the technology and facilities employed in the early stages are likely to be outgrown in terms of specification and size fairly shortly. Outsourcing can provide the retailer with the flexibility to grow and adopt technology and practices as its business requires it.

Some specialist service providers have emerged from the home shopping and catalogue sector. Companies such as Home Delivery Network, Parcelnet, and Zendor have evolved from Littlewoods, Grattan, and N Brown respectively. Whilst typically handling the established retailer's home delivery requirements, these home delivery specialists have also secured home delivery and e-fulfilment contracts with other major retailers, including Next, Mothercare, Amazon, Tesco, and River Island.

A number of specialist e-fulfilment providers have also emerged. Companies like iForce, Unipart, and Zendor offer an integrated order processing and distribution service, including picking, packing, carrier selection, returns, and replenishment and use carriers and postal operators to deliver goods to customers.

These specialists offer e-tailers expertise in the home delivery sector from years of experience and expertise in e-fulfilment processes. As internet spending increases, the number of parcels to be delivered to online customers is expected to reach 860 million parcels in 2007 — up from 540 million in 2006. With this growth and even more retailers entering the e-commerce market, the e-fulfilment and home delivery outsourcing providers will be well placed to service their requirements.

Exhibit 4
Alternative online sales distribution models — advantages and disadvantages

Model	Typical retailer profile and examples	Advantages	Disadvantages
In-store picking	• The in-store picking model works best where the retailer has a broad geographic presence and offers a wide range of products. • The major adopters of this model have been supermarkets for the online sale of groceries.	• Market penetration – online sales can be offered to customers through stores, achieving a greater degree of market penetration more quickly than if using dedicated warehouses only. • Cost benefits - little need to take on significantly more warehouse space.	• Stock substitutions – there is a greater risk of stock-outs because of the difficulties predicting types and volumes of products ordered online and the greater volumes of goods sold. • Inefficient design – stores are designed for customer satisfaction, not efficient picking systems. Stores are not conducive to picking and packing efficiencies.
Direct from warehouse	• This model is used by most e-tailers – including multi-channel retailers, "pure" e-tailers, and manufacturers – across many product lines including furniture and homewares, CDs, DVDs and books, clothing, electronics, and electrical items. • Decision of whether to use a national distribution centre (NDC) or a regional distribution centre (RDC) network will also depend on the retailer's customer network and the size and the type of product being moved. • Manufacturers and wholesalers may deliver goods directly to customers without the intermediation of a retailer.	• Operating efficiencies – warehouses are arranged specifically for the picking of online delivery "baskets" rather than for a retail experience. Warehouse space will be designed expressly for distribution picking, and logistics technology (eg, personal computers, storage systems) is more likely to be deployed. • Better able to meet customer's demands, as products are picked directly from the warehouse. It is more likely that customers will get what they order. • Consolidation of operations into single multi-purpose unit; customer service and ordering centres are often co-located with warehouses offering internet sales delivery, resulting in lower costs.	• "Product miles" – goods may have to travel hundreds of miles from an NDC or RDC (particularly where distribution networks are arranged by product type rather than customer geography). • Inability to reach greatest number of customers quickly – distribution from a single location may mean that online sales are only available within a selected area or that delivery may take longer to the farthest customers. • Product line constraints – there may be a limit to the number of product lines that can be contained within a warehouse, so that online service may not offer the full product lines available in-store.
Outsourced	• 3PLs may be hired either (a) to manage a retailer's warehouse and distribution operations or (b) to distribute a retailer's goods from its own network of warehouses and delivery vehicles. • The decision to outsource their efulfilment and home delivery ultimately comes down to whether or not a 3PL can add value.	• Cost savings – using a 3PL can represent significant cost savings and flexibility either through access to a dedicated operator's expertise in logistics, economies of scale, or multi-client facilities. • Existing networks –setting up a fully integrated delivery service is costly, especially for smaller businesses. Therefore, the ability to tap into broad distribution networks – eg, carriers and postal operators – will reduce initial costs and facilitate growth. • Emphasis on core business strengths, with non-core operations outsourced to a specialist operator.	• Area of potential strategic advantage taken out of house – reliance on external party to provide distribution solutions – any failure to deliver as and when the customer expects when they place their orders will result in reputation damage to the retailer.

Source: Gerald Eve

Books, CDs, and DVDs ordered online from Amazon.co.uk will be delivered directly to the customers. The pictured e-fulfilment facility is located in ProLogis Park Marston Gate, East Midlands.

When, for example, Screwfix Direct, a hardware supplier, completely reconfigured its fulfilment operations in 2002, it relocated its direct delivery operation to a 410,000 sq ft facility in Stoke-on-Trent. As a result, it expanded its capacity by 40%, as well as allowed implementation of automation and carrier selection software to meet its overnight delivery promise and reduce the cost of order fulfilment.

The bigger retailers often gravitate toward bigger facilities. Larger retailers with numerous products typically have taken warehouses with 100,000 - 400,000 sq ft as central or regional distribution facilities. In a few instances, retailers have taken significantly larger warehouses of over 500,000 sq ft, but these have tended to be the pure e-tailers (see Exhibit 5).

The bigger retailers often gravitate toward bigger distribution facilities.

Smaller retailers

Smaller, niche operators are more likely to opt for a national distribution strategy. Their sales volumes are smaller, with commensurately smaller numbers of orders to process and smaller amounts of stock to be handled. Clothing e-tailers ASOS.com and Boden, for example, have national distribution centres to handle all their distribution in Hemel Hempstead, Hertfordshire and Leicester respectively.

The size of the products that are being handled also contributes to the required specification of warehouse. Warehouses used to store larger, bulkier goods — like furniture and white goods — will typically require higher eaves to provide required cubic volume.

However, in planning the ideal size of a new distribution facility, the most important determinant is the volume of goods sold. The greater the volume of goods sold, the more space will be needed to store and distribute those goods. For example, in 2005, the pure e-tailer ASOS.com moved from small facilities totalling less than 20,000 sq ft of floorspace to a dedicated 70,000 sq ft warehouse in Hemel Hempstead. Its sales have gone from under £2m in 2001 to £38.4m in 2006-07 — a more than 2000% increase in sales despite devastating damage to its warehouse and stock in December 2005, just before the peak Christmas season.

Carriers

In planning the ideal size of a new distribution facility, the most important determinant is the volume of goods sold.

Sorting centres and delivery platforms are also required by the postal and parcel carriers and delivery specialists used to deliver internet purchases to their final destination.

Carriers collect the goods from the retailer's warehouse and then deliver individual orders to the customers from their appropriate delivery centres. Their typical delivery centre is between 10,000 and 50,000 sq ft and is usually located in or near a population centre. Royal Mail has over 1,500 such centres; and major operators like Parcelforce, Home Delivery Network, TNT, DHL, and Business Post have between 40 and 60 delivery centres.

Online grocery sales — not everyone is in the game

Online sales of groceries are estimated to have exceeded £3bn in 2006. The supermarket chains dominate online grocery sales. Tesco is the market leader, with about £950 million in online sales of groceries and other products in 2006. Waitrose (through Ocado), Sainsbury's, and Asda all offer online grocery shopping as well. However, their distribution strategies have evolved very differently.

When Tesco began offering online ordering of groceries, the company decided to distribute goods from its store network rather than from a separate distribution warehouse. This strategy, they claimed, enabled the retailer to grow quickly and expand its potential customer base. Indeed, since its launch in 2000, the UK's largest retailer can offer online grocery sales to 96% of the UK population.

In contrast, both Sainsbury's and Asda also started offering online grocery sales at around the same time as Tesco, but opted for a different distribution strategy. They both opened dedicated warehouses to serve the UK's largest markets for grocery sales — Greater London. Sainsbury's took a 120,00 sq ft warehouse in Park Royal, north west London in 1999. Asda leased two sheds totalling 50,000 sq ft, one in Watford, north London and the other in Croydon, south London. Sainsbury's also took a 70,000 sq ft warehouse in Gorton, near Manchester, to handle home deliveries in Manchester and Liverpool.

Exhibit 5
Key distribution warehouses for distance sales fulfilment — 2004 to 2007

Location	Date	Occupier	Event	Size (sq ft)
Swansea, South Wales	2007 Q2	Amazon.co.uk	Pre-Let	807,300
Darlington, North Yorkshire	2004 Q3	Argos	Sale	750,000
Magor, Newport	2007 Q3	Home Retail Group	Pre-Let	750,000
Crewe, Cheshire	2006 Q3	Tesco	Let	390,765
Gourock, Inverclyde, Scotland	2004 Q2	Amazon.co.uk	Development Sold	300,000
Daventry, Northamptonshire	2006 Q2	Tesco	Conversion	250,000
Redditch, Worcestershire	2007 Q3	iForce (for John Lewis Direct)	Let	237,444
Glenrothes, Fife, Scotland	2005 Q3	Amazon.co.uk	Let	210,000
Gloucester, Gloucestershire	2005 Q3	Direct Wines	Let	186,129
Croydon, South London	2005 Q4	Tesco	Let	172,712
Birmingham, West Midlands	2006 Q1	iForce (for Boots the Chemist)	Let	165,940
Hemel Hempstead, Hertfordshire	2007 Q3	ASOS.com Ltd	Let	158,000
Burton-upon-Trent, Staffordshire	2007 Q4	Unipart Logistics (for Waterstone's)	Let	157,500
Chadderton, Manchester	2006 Q2	Zendor	Let	145,000
Glenrothes, Fife, Scotland	2006 Q3	Amazon.co.uk	Let	105,000
Hemel Hempstead, Hertfordshire	2005 Q2	ASOS.com Ltd	Let	70,490

Source: Gerald Eve

Ocado's order fulfilment facilities are highly automated. Each coloured tote serves as a "shopping basket" with the grocery items for a particular order. When completed, each order is whisked to a virtual checkout, where it is bagged and then sent to the customer.

David Levene, 2006

However, Asda flip-flopped in 2002. It announced that it had decided to turn to a full in-store picking service and closed the two London warehouses. Company officials gave two reasons for the switch. First, they said that a greater proportion of Asda's product range would be available through its stores as compared with its warehouse capacity. They also maintained that the new strategy would enable them to increase the service's geographical coverage in a shorter time and also greatly improve productivity and operational efficiency.

Similarly, Sainsbury's also moved toward a full in-store picking regime. It had been using a hybrid model relying on warehouses in areas of significant population — London and Manchester — and on in-store distribution elsewhere. Sainsbury's closed its Gorton warehouse in 2002 and conducted home delivery in Manchester from three refurbished stores. It followed this with closure of the Park Royal warehouse in 2004, reportedly in response to the cripplingly high costs involved in running the specialist facility.

Not all supermarket chains have embraced the in-store model. The other major supermarket chain offering online grocery sales is Waitrose. Its online grocery sales are handled through Ocado, a subsidiary of Waitrose that was launched in 2002 as a partnership between the supermarket chain's parent company and former Goldman Sachs investment bankers. Despite £300m turnover and sales growing at 30% per annum, the company is still turning a loss rather than profit. However, there are rumours that the business is considering borrowing heavily and expanding into non-food items.

Ocado also relies on a totally different fulfilment strategy — distribution warehouses. Its first and largest warehouse is a 370,000 sq ft facility leased in 2002 and located in Hatfield. It distributes groceries from the Hatfield facility to the London and South East markets — Waitrose's heartland. Since 2002, it has supplemented its Hatfield facility with warehouses in several locations including Aylesford (Kent), Manchester, and Rugby (Warwickshire), with more expected as the company extends its reach.

Intriguingly, the market dominator, Tesco, whose model of in-store picking has been replicated and evidently validated by its rivals Sainsbury's and Asda, has recently taken 173,000 sq ft of warehouse space in Croydon to supplement its in-store picking model. In doing so, Tesco advised that whilst its core in-store picking model would remain its "basic approach," it had taken the Croydon warehouse to "relieve pressure on busy stores and fill in gaps where coverage is limited."

Not all supermarket operators have jumped on the online grocery bandwagon. Several major operators — including the fourth largest supermarket in the country, Morrisons — do not offer online sales of groceries. And any grocery chains that are contemplating entering this highly competitive market face two big hurdles. First and foremost is the keen competition that currently exists. The second is the high cost of initial infrastructure needed to launch an online grocery business.

Tesco, whose model of in-store picking has been replicated and evidently validated by its rivals Sainsbury's and Asda, has recently taken 173,000 sq ft of warehouse space in Croydon.

Pictured is the Corbiere Lighthouse at Corbiere Point on the island of Jersey. E-tailers based in the Channel Islands can under-price their UK-based competitors for many kinds of low-value products. Consequently, the Channel Islands have become a distribution "hot spot" for the UK.

Channel Islands — distribution hot spot for the UK?

> Pure e-tailers like Play.com and Blahdvd.com have located their distribution operations wholly on the island of Jersey.

Over the past several years, retailers have discovered a highly effective strategy for distributing low value goods purchased online in the UK — locating in non-EU locations.

Currently, when goods are imported into the United Kingdom from a non EU territory, an excise duty — set at the same rate as the Value Added Tax (VAT) of 17.5% — is levied. However, an EU regulation called the Low Value Consignment Relief (LVCR) exempts shipments from the excise tax when the total value is less than £18. Hence, low-value goods sold from non-EU territories avoid both the VAT and excise duty.

Retailers operating from the Channel Islands thus can offer many kinds of goods at lower prices than their UK-based competitors because the extra cost of postage is usually outweighed by the savings from the lack of VAT or excise duty. Moreover, although the Channel Islands are outside the UK for taxation and administrative purposes, they are part of the UK postal system and postage charges are lower than those for other non-EU territories. Several retailers have established distribution operations in the Channel Islands for the sale of low value items — particularly CDs and DVDs — to customers in the UK.

Pure e-tailers like Play.com and Blahdvd.com have located their distribution operations wholly on the island of Jersey. Goods are imported to their warehouses from manufacturers outside Jersey, and then sent to customers in the UK. A large number of UK retailers — including Tesco, HMV, Asda, Amazon, Woolworths, and WH Smith — have also set up online sales and e-fulfilment operations on the islands. However, their operations typically involve UK-sourced goods that are exported to the Channel Islands and then shipped back to UK customers without attracting VAT.

Bruno Vincent, Getty Images, 2007

Amazon.co.uk has organized its order-fulfilment facility into palletized “islands.” Each pallet contains a separate title. Workers wheel small carts among the pallets, assembling the books needed to fill customers’ orders.

Those UK businesses that have lost sales to online operators distributing from the Channel Islands have complained bitterly. The Forum for Private Business (FPB) has initiated a judicial review of HM Treasury to challenge its failure to prevent the “loophole” from being exploited. The FPB claims that the government has not done enough to ensure that the law is not abused and wants the government either to exempt particular goods from LVCR or lower the threshold for exemption to £7 from the current £18.

The Jersey government has also taken action to encourage proper use of the exemption, although it is understandably circumspect in taking a hard line. Based on its review of the fulfilment industry on the island, it has established two categories into which businesses can be classified — whole chain companies (WCC) and third party service providers (3PS). WCCs are businesses that “physically buy in and own the stock and sell the goods to the final customers”. 3PSs, however, “provide logistics or distribution services to other retailers”.

In early 2006, the Jersey government announced that UK businesses wishing to continue in the CD/DVD market through a 3PS firm on Jersey would need to apply for a licence to continue operations, but would also have to gradually reduce and eventually to discontinue their activities. Jersey authorities have already acted by refusing to renew Tesco’s licence to operate on the island, forcing it to close its fulfilment operations. However, to continue to enjoy the benefit of LVCR, Tesco has moved those fulfilment operations to Zurich, Switzerland, which is also outside the EU. CDs and DVDs are posted from Zurich back to the UK after stock has been delivered from its distributor’s warehouses in England. It has been reported that orders are being processed and envelopes packed in west London.

However, retailers like Tesco are beginning to be pressured to consider the environmental impact of sending goods from the UK to another country simply for redelivery back to the UK. Such sustainability concerns will particularly affect retailers that are attempting to highlight their consideration for the environment, like the large UK brands.

Home delivery — anyone home?

Retailers are also searching for new and better ways of delivering goods to their customers. Whilst home delivery has long been established in the UK, never before has there been the demand for home delivery on the scale it is today.

Retailers are also searching for new and better ways of delivering goods to their customers.

One of the biggest issues in home delivery is flexibility. Customers are demanding more delivery options when ordering online, particularly relating to the time of delivery. In turn, retailers are increasingly offering more delivery time options to customers.

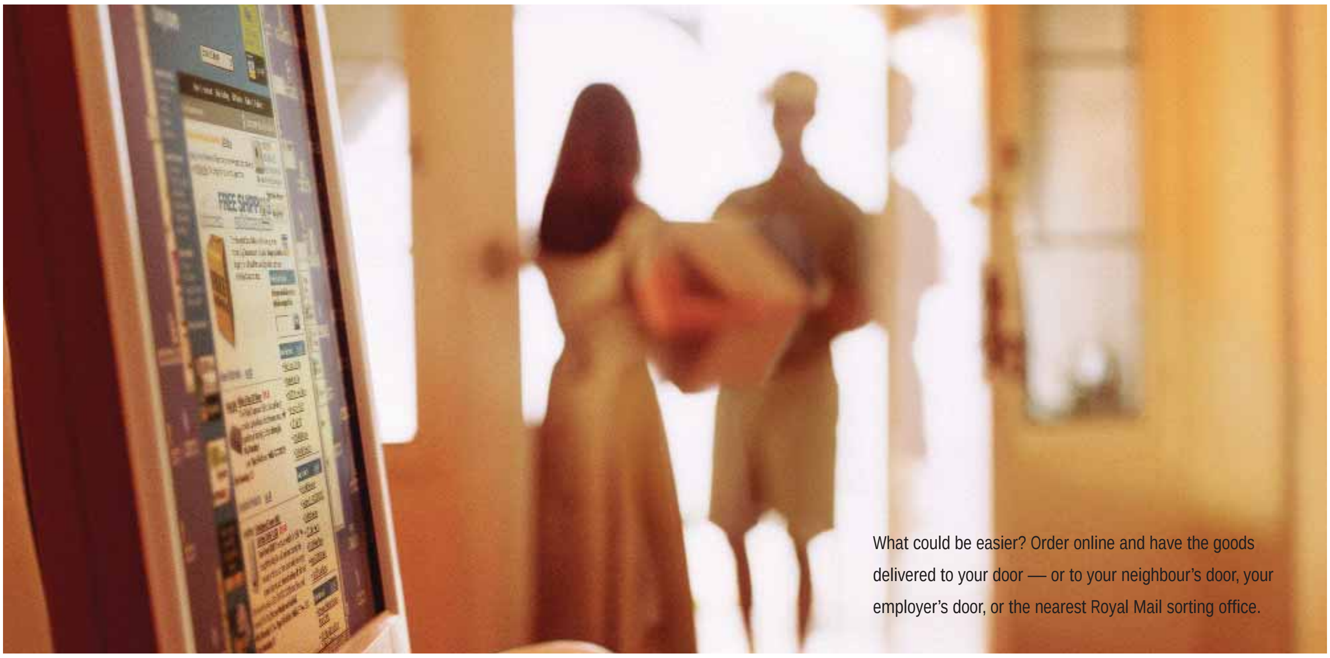
Research by Snow Valley, an e-commerce consultancy, revealed that in 2006, 57% of the sampled retailers offered delivery time options, a slight improvement from the previous year when 54% offered such options. However, when considering the larger retailers who feature in the IMRG's list of the Top 50 UK Sites, 70% offered delivery options — a marked difference between the broader market, reflecting perhaps the strength of their market presence and the importance of their online channel of sales to their businesses. Some e-tailers are now offering express/next day and time- and date-specific deliveries as well as standard services, and some are also offering Saturday and evening deliveries.

But delivery flexibility is costly. Some consumers are willing to pay for greater ability to choose when goods are delivered, but others are cost-sensitive. Whilst most online consumers say that they would like to have greater flexibility in terms of delivery times, only those who are willing to pay extra for it will actually get it.

Consumers would also prefer more flexibility about where "home" deliveries will be made. Many people in the UK, it turns out, are not at home during the daytime. The number of working households — those where all household members of working age are employed — has increased by 22% between 1992 and 2006.

Research conducted by Royal Mail found that fewer consumers are having goods delivered to their homes (92% in 2006, down from 97% in 2004). Many shoppers were having packages sent to alternative locations such as neighbours, Royal Mail sorting offices, or work addresses. Clearly, an e-tailer's ability to offer flexibility to have goods delivered to an alternative address is likely to appeal to more and more people (see Box 2).

Ed Honowitz, Getty Images, 2007



What could be easier? Order online and have the goods delivered to your door — or to your neighbour's door, your employer's door, or the nearest Royal Mail sorting office.

Some retailers like clothing retailer Next and booksellers Waterstone's and WH Smith are offering collection from the customer's nearest store in lieu of home delivery, which is likely to appeal to people who work in urban or inner city areas. Other retailers (for example, Tesco) are also offering collection in-store so that consumers can combine collection of goods purchased online with other shopping trips. Other retailers are also catering to the consumer who researches products online but prefers to purchase in-store. For example, PC World and Argos allow consumers to reserve an item at a nearby store and then pay in-store upon collection.

This in-store collection model may evolve to include other retailers and other products. In recent years, however, retailers have been attempting to re-design store layouts in order to minimise storage space and maximise selling areas. As a result, the just-in-time delivery model has evolved so that stores are supplied with goods only when they need to be put on shelves. Offering in-store collection for larger items is likely to work where the stores already have the goods in stock or have space to store them (for example, in retail warehouses, large supermarkets and larger stores), or where goods are sufficiently small and will not create significant competition for selling space in stores (for example, books and clothing).

Ultimately, tailoring deliveries to meet the needs and demands of customers should be beneficial for retailers. They will have fewer failed-delivery returns and redeliveries to handle and more satisfied customers. Pleased customers are likelier to be loyal customers.

Virtually everyone expects online retailing to continue to grow and increase its penetration of total retail sales.

What will happen next?

Virtually everyone expects online retailing to continue to grow and increase its penetration of total retail sales. Projections prepared by Forrester Research, for example, suggest that internet sales will soar nearly 90% during 2006-11, whilst total retail sales will grow just under 15%. As a result, online spending for physical goods is projected to increase its share of total retail spending for goods to about 15% in 2011 from 10% in 2006 (see Exhibit 6).

What is the impetus for this rapid growth in online sales, and what might possibly derail it? One key factor will be people's access to the internet. National Statistics reports that, in 2002, 46% of the population had access to the internet at home and 79% of businesses had internet access. Three years later, 89% of businesses had access. Four years later, home internet access had risen to 57%.

One of the major propellants of this growth is accessibility of broadband. Users can connect with the internet much faster and easier via broadband than with dial-up. The number of homes connected to broadband is estimated to have increased 12% from 2005 to 2006 to 40% of all households. Similarly, over two-thirds of all businesses now connect to the internet by broadband, up from around just a quarter in 2002.

In the future, broadband usage should become even more widespread. PointTopic, a specialist research consultancy, is projecting that 64% of the UK's households will be connected to broadband by the end of 2008. In that event, it is likely that more people will begin to shop online, given the improved speed of access and use that broadband delivers.

Box 2: Thinking outside the box

The “nobody home” problem is a major headache for internet retailers. Several companies have come up with creative solutions:

Drop boxes: The basic idea is that packages are delivered to a drop box rather than to a home; and the customer is given the means to access the drop box, such as a pin code or a bar code for scanning, and collect the item. (Companies like ByBox, BearBox, and Business Direct’s ParcelXchange have successfully implemented drop boxes in the field service market.) Petrol stations have been used as locations for box banks in the field service market, but drop boxes could be located in such “consumer-friendly” locations as supermarkets. However, success will depend on wide reach, which requires large networks. The networks currently available do not have the critical mass required to service the B2C market effectively, but there is market potential for this model.

Collection from manned locations: Royal Mail will hold packages for consumers at their local Post Office branches, and retailers can also provide their customers with the option of delivery to a Post Office branch at the point of order. With the broadest reach of all delivery services, Royal Mail appears to be the market leader. But other operations are emerging: a service called MyParcel has been launched on trial at five locations in London. Packages are delivered to Safestore self storage locations where they are held for collection at the customers’ convenience, even weeks later.

Controlled access: Another solution is controlled access such as centrally-controlled electronic keypads or electronic key safes. A service called “A Home 4 It” offers electronic key safes that are accessed by a code that the customer or service operator provides to couriers delivering goods to unattended premises. The courier then accesses the home or garage, leaves the goods, and returns the key. BearBox also offers controlled access though the installation of keypad-operated locks; access to codes can be granted by users on a temporary or permanent basis over the internet. Whilst there is little information regarding the take-up of these models, DHL has adopted BearBox’s controlled access keypads to provide secure access to depots for overnight delivery drivers.

Delivery with existing services: Superdrug.com trialled a system in 2000 operated by a company called m-Box that put deliveries of goods bought online on Express Dairies’ milkfloats. Goods were not express parcels but 48-hour delivery packages. It appears that the system was not adopted on a broader basis.

One of the major propellants of this growth is accessibility of broadband. In the future, broadband usage should become even more widespread.

Online consumers' concerns

> Almost half of all respondents who had had a problem with online shopping during the past twelve months reported that the problem centred on delivery.

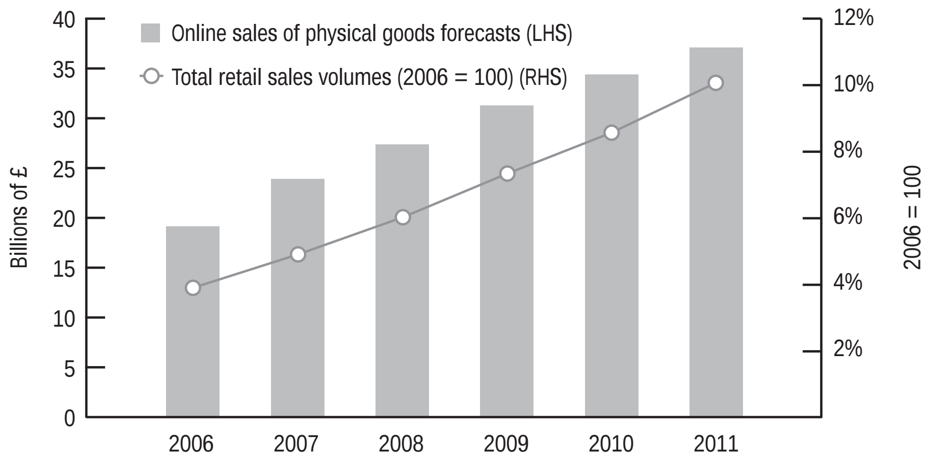
How fast online retailing grows also depends on consumer confidence in buying online. In a recent survey of over 1,000 people by the OFT, people reported that their two greatest concerns in using the internet are (1) having their financial details divulged (79% of respondents) and (2) having their personal details divulged (31%). Also, although internet shoppers appear to have gained confidence over time, even experienced users continue to be worried about the security of their financial and personal information.

The popularity of online shopping will also be affected by the service levels that e-tailers provide, particularly with regard to delivery. According to the OFT's survey, the most common type of problem experienced by online shoppers is related to delivery. Almost half of all respondents who had had a problem with online shopping during the past twelve months reported that the problem centred on delivery.

Delivery problems come in many guises. Some are related to communication problems such as difficulty contacting the retailer. Other common complaints are that the goods delivered were wrong, damaged, faulty, or inferior quality. Businesses surveyed by the OFT suggested that many of the delivery problems experienced by online shoppers are due to the lack of experience of some online retailers who have newly entered the market, but that these problems would be "ironed out," especially with the use of order tracking. Order tracking and other improvements to customer care should improve online consumers' ability to communicate with e-tailers.

Mishandled returns and refunds are another common annoyance. The OFT survey revealed that difficulties with refunds and returns accounted for 16% of the problems that online consumers said they had experienced. However, according to a recent report by Royal Mail, many retailers admit readily that they have not yet mastered returns and refunds through their high-street operations, let alone through their online or multi-channel models. Royal Mail has estimated that retailers' failure to manage returned merchandise cost them as much as £500m per annum.

Exhibit 6
Projected total retail sales volumes and online spending on physical goods in the UK — 2006-11



Sources: Forrester Research and Experian.

Warehousing requirements

If online retailing does grow as much as Forrester's projections suggest, the e-tailers will have to expand their warehousing requirements suitably (see Boxes 3 and 4). How those requirements will be affected depends not only on the growth of online sales versus highstreet sales, but also on the individual retailers' decisions regarding their distribution models.

Several different scenarios may unfold. For instance, where operators combine store and online sales distribution into a single warehouse or network of warehouses, the retailers may have to allot more of their existing space to online sales distribution and less to store sales distribution insofar as online sales replace store sales.

If the retailing business is growing in all channels of sale, operators will have to arrange to take more floor space, either as a larger warehouse or more warehouses. Operators may also decide to take more warehouse space if their online sales distribution/delivery is separated from their store network supply chain. Depending on their expectations for their online sales profiles, operators may prefer to take the extra space on a leasehold basis for greater flexibility or alternatively, on a freehold basis or long leasehold to secure the strategic advantage.

If online retailing does grow as much as Forrester's projections suggest, the e-tailers will have to expand their warehousing requirements suitably.

Box 3: Tesco and Argos

Multi-merchandisers Tesco and Argos both offer online sales of thousands of different types of non-food products including furniture, homewares, electricals, and electronics. Both have adopted a multi-site and multi-delivery type distribution strategy. Both have also split their home delivery warehouses from their main store distribution warehouses. And both have split their products requiring one-person and two-person delivery into separate warehouse networks.

Tesco has a single NDC in Daventry for one-person deliveries, whilst Argos has two RDCs, one in Welwyn Garden City and the other in Manchester, for one-person deliveries. For two-person deliveries, Argos has three warehouses — Acton Gate, near Stafford, Bedford, and Faverdale, near Darlington. Argos' Acton Gate warehouse used to be the single NDC for two-person deliveries but now serves the central part of the country, whilst the Bedford warehouse (opened in 2003) serves the south and the Faverdale shed (opened in 2005) covers northern England and Scotland.

Tesco's non-food online sales offering called Tesco Direct was initiated in August 2006, and those sales are handled from a 380,000 sq ft warehouse in Crewe, Cheshire. Tesco has also said that it will continue to "build the strength and capability of the infrastructure behind the business" as it grows, suggesting that they will require more space in the coming years.

Tesco appears to have taken the market experience on board and has strategically located its warehouses to achieve high levels of service in its home deliveries.

The internet retailers have tended to locate their distribution facilities in much the same places preferred by the traditional retailers. Specifically, the attributes that they both prize are good road connections and access, appropriate labour market dynamics, and the right property. Among the e-tailers, good road connections are particularly important for home delivery where time slots have been promised and service levels agreed.

Equally high on e-tailers' list of location attributes are the size of the local labour pool, the prevailing local wage rate, and flexibility in staffing — that is, the ability to recruit and lay off temporary staff, particularly at peak times like Christmas. These staffing issues exert a significant impact not only on the level of service that can be delivered, but also on the cost of providing that service.

Finally, finding the right property for the right type of distribution is critical. Availability of units or land in an area that meets the retailer's requirements is important. Unit size will depend on the retailer and its supply chain strategy, but unit specification typically needs to be flexible (particularly for 3PLs) to accommodate changing product types.

Warehouse location will also depend on the type of retailer and their distribution strategies as well as the location of customers. Forrester Research's projections call for total online sales of physical goods to grow to about £37bn in 2011. We have modelled the geographic location of where different types of goods will be purchased based on household spending profiles and forecasted levels of overall spending. Hence, total online spending is likely to concentrate around major population centres in the North West, Midlands, and particularly the South East (see Map 1).

Box 4: Amazon.co.uk

Amazon.co.uk's warehousing strategy has evolved since its entry to the UK market in 1998. Its first major distribution warehouse was a 730,000 sq ft unit at ProLogis Park Marston Gate, just off Junction 13 of the M1. This warehouse is in a prime location for distribution to large numbers of people, with 80% of the population capable of being reached within a national drivetime of 4.5 hours. Given the nature of the products being delivered – mostly small, low-value items such as CDs, DVDs, and books — the retailer uses the postal system to deliver goods from its warehouse to the entire country.

In 2004, Amazon.co.uk opened a 300,000 sq ft "fulfilment centre" in Gourock, Inverclyde to handle products other than books, music, and DVDs, such as electronic and photographic goods, toys, garden products and homewares. In autumn 2005, it opened a 200,000 sq ft warehouse in Glenrothes, Fife that took over handling those products from the Gourock site, which then switched to more traditional items. Both sites support the main national distribution facility at Marston Gate.

In March 2007, Amazon announced that it would be opening a new 800,000 sq ft distribution centre in South Wales near Swansea. Work on the project began in April 2007, but construction of the first 400,000 sq ft phase has been delayed beyond the planned October 2007 completion date. According to the company, Amazon chose South Wales because of its location and the availability of labour; the Welsh National Assembly has also provided Amazon with regional selective assistance grant aid. This new warehouse will handle orders mainly for the UK market but also abroad.

Considering that Amazon uses the postal system (although the company announced it had cancelled its £8m contract with Royal Mail in June 2007) and carriers like Parcelforce and Home Delivery Network, the pure e-tailer has more options open to it for location of its distribution warehouses. Whilst the central Marston Gate operation is ideally located with a huge reach of the national population, the Scottish and Welsh locations offer availability of sizeable sites at reasonable cost and with available and affordable labour pools, but still with ready access to the national postal network because of good transport links.

Groceries

The online grocery market is expected to more than double during the next five years. By 2011, it should amount to over £7bn — or almost 9% of total spending on groceries in the UK. Such spending is likely to grow across the entire country, with especially rapid growth occurring around the major population centres — particularly those in the more affluent South East, and the major towns and cities in the North and North West.

Whilst some incremental warehouse space will be needed to accommodate this growth in the market for online groceries, it will probably be limited in scope. How much additional floorspace will be needed depends, first, on how many new e-tailers enter the market and, second, on what model they use for distribution/delivery.

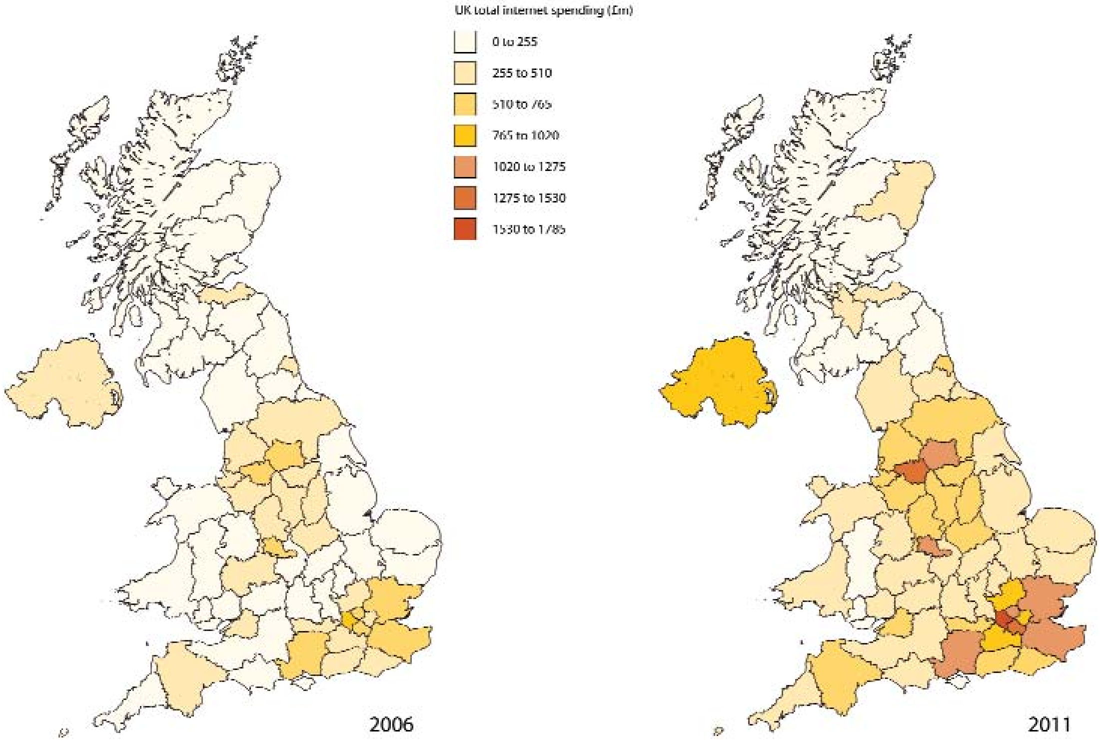
The Tesco model seems to work well for retailers who already have a significant "bricks and mortar" presence. Such grocery chains already have a wide-ranging retail network that can be utilised to extend its multi-channel offering. With substantial investment capital already committed to stores, the extra cost of handling the distribution of online grocery sales from the stores becomes just a "pimple" on total cost. However, where market penetration of the stores is limited, warehouses may have to be used to supplement the in-store picking model and deepen the service offered. This is reminiscent of the hybrid model pioneered by Tesco.

Alternatively, in those cases where a retailer lacks presence in local markets where it would like to offer online service, one way to enter those markets is to channel the distribution and deliveries out of warehouses. Ocado has demonstrated that this strategy is viable, though it entails early pain — in terms of upfront capital costs for setting up regional distribution centres and potential waste costs that are not experienced as heavily in stores.

Should a major "bricks and mortar" retailer like Morrisons choose to offer online grocery ordering — and the company has indicated that it is contemplating doing so — it is likely to follow the lead of the existing online competitors and adopt the in-store picking model. This strategy yields the most efficient use of existing facilities and avoids major initial capital outlays.

Whilst some incremental warehouse space will be needed to accommodate this growth in the market for online groceries, it will probably be limited in scope.

Map 1
Total online spending by county and by spending levels: 2006 and 2011



Source: Forrester Research, National Statistics and Gerald Eve

> Clothing retailers will probably need to increase the floorspace that they take for use in processing orders as well as picking, labelling, wrapping, and packing.

Clothing and footwear

Clothing and footwear constitute one of the largest markets for online spending, with consumers currently spending an estimated £2bn. Online spending for such merchandise is soaring and expected to exceed £8.5bn by 2011, when it will represent almost a quarter of internet spending on all physical goods.

Those retailers and manufacturers catering to this segment of the online shopping market generally use postal services and carriers for delivery. Given the breadth of geographic coverage needed to be reached, it is highly unlikely that any retailer or manufacturer would attempt to establish a bespoke delivery service in-house. Hence, going forward, we foresee an increased need for sorting centres and delivery platforms between 10,000 and 50,000 sq ft across the country, particularly in and near major urban centres with heavy concentrations of population.

Additionally, clothing retailers will probably need to increase the floorspace that they take for use in processing orders as well as picking, labelling, wrapping, and packing. These tasks may be completed within their own warehouses or outsourced to a 3PL. Given the nature of delivery — from warehouse to postal or parcel carrier to customer — it is likely that the warehouses will be either national or regional distribution centres and will vary by size according to volume of goods sold. Retailers may decide to offer in-store collection to their online customers where appropriate, although typically only retailers with a large retail network will offer this service.

Books, CDs, and DVDs

With the UK government under mounting pressure to stop retailers from abusing the LVCR by locating e-fulfilment operations in the Channel Islands and Jersey, retailers may consider alternative locations for delivery of their low-value products, particularly CDs and DVDs. However, large retailers like Tesco will still seek to preserve the tax advantage the LVCR delivers; and if asked to cease their operations on Jersey, they are likely to move their operations to locations like Switzerland.

Nevertheless, despite the tax advantages to offshore locations, retailers are likely to increase their demand for warehouses located within the UK. Amazon, for example, has shown that rapid growth — especially into new, higher value product areas — has meant that more space has been required on UK shores. And as more operators are pressured to prove their environmental credentials, they may be forced into moving their distribution facilities back within the UK.

Looking ahead, more and more retailers are also likely to offer their online customers the delivery option of in-store collection. Storing small items like books, CDs, and DVDs for collection should be manageable and relatively inexpensive within a store environment, and more retailers are likely to offer the service as their multi-channel offering deepens.

Big, bulky items

Retailers selling goods requiring one and two-person delivery teams — eg, furniture, white goods, appliances, computers, DIY, and garden equipment — are likely to maintain strategies of national or regional distribution, depending on the size of retailer, the number of product lines, and the retailer network. Carriers are likely to continue to handle operations for retailers, especially in the one-person networks where there are huge infrastructure costs associated with building a national delivery network from scratch.

The number, location and sizes of distribution centres will depend on customer bases and the distribution strategy selected, particularly if a retailer plans a multi-site strategy. If a two-unit strategy were chosen, the locations would be quite different than those used in a three-unit or one-unit strategy.

Retailers will continue to offer in-store collection as an alternative to home delivery, although for large, bulky items like furniture this option will be less practical for both customers and retailers. However, some retailers may consider opening collection points for bulkier products, typically away from busy shopping areas as well as stores where space is costly. Others may make greater use of in-store collection points in large retail warehouse units and supermarkets. Alternatively, some retailers may create distribution/delivery outlets in small industrial units on industrial estates near major population centres. However, retailers will always seek to maximise efficiency of existing infrastructure before investing in new space.

Retailers are battling for market share in every channel, and the stunning growth in internet sales is likely to mean more retailers seeking to capture their “fair share” of this new, dynamic market.

Conclusions

The multi-channel retail sales environment has become exceptionally competitive. Retailers are battling for market share in every channel, and the stunning growth in internet sales is likely to mean more retailers seeking to capture a share of this new, dynamic market.

The projected growth in online sales of different products will entail varying warehouse space requirements for handling different products. Growth in online grocery sales will probably not add much to the demand for distribution floorspace; the preferred model for filling these orders is to do so at the chain's existing supermarkets. However, some supermarket chains will have to deepen their service with warehouses where their store coverage is limited or where they are looking to enter new geographic markets.

In contrast, retailers of non-grocery products are more likely to require additional warehouse floorspace to deliver goods bought online. However, their warehousing strategies — ie, the number, size, and locations of their distribution facilities — will depend on many factors, including the size of the retailer and its retail network, the type of products sold, the online delivery/distribution strategy, and the location of customers. In choosing where to locate the new facilities, internet retailers will opt for good transport links, cost and flexibility of labour, and availability of appropriate existing facilities or land — essentially the same list of attributes that traditional "bricks and mortar" retailers also prefer for their distribution facilities.

To date, the take-up of warehousing for online sales distribution has not represented a huge volume of floorspace. Of the more than 50 million square feet of additional warehousing space taken up by retailers during the past five years, we estimate that less than 10% is being used specifically for online sales fulfilment.

In 2002 Screwfix Direct relocated its direct delivery operation to a 410,000 sq ft warehouse in Stoke-on-Trent.

However, online retailers' warehousing needs are likely to grow briskly in coming years. In view of the projected rapid growth of online sales, the increasing importance of multi-channel marketing, and the ongoing improvements in internet security and access, internet retailing will likely become an increasingly important — and crowded — retailing channel. And the internet retailers, new and old, will have to rethink their strategies for managing home delivery — and, in turn, their warehousing requirements. They may end up requiring more warehousing space; but as the market is still undecided about the best distribution models for different product types, it is as yet unclear to what extent the take-up of logistics property will be affected.

Certain warehouse market niches will benefit greatly. With the expected increase in internet sales and continuing use of 3PLs and carriers, demand is likely to grow for sorting and delivery centres of 10,000-to-50,000 sq ft and possibly home delivery platforms of less than 20,000 sq ft in areas of major population densities. The South East, Greater Manchester, West Yorkshire, and parts of the Midlands are expected to enjoy significant growth in online sales of physical goods; and appropriate space may be sought throughout the region or in key gateway locations such as on the edge of major urban areas near good roadway connections.

Going forward, the multi-merchandisers and major retailers will be key players to watch — not just because of the current size of their online retailing operations, but also because of their eagerness to expand their online market shares. Companies like Argos, Tesco, and Amazon have all strengthened their online market presences recently, and other major players like Asda, Woolworths, and Marks & Spencer are also ramping up their offerings.

To a large extent, the success of any retailer's e-commerce strategy will depend on how effectively it delivers the right goods, on time, to consumers. Retailers must think very carefully about the best way to configure their online distribution strategies and make sure they make the right property choices to fit their — and their customers' — needs.

From the Editor

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Online shopping is having a profound impact on the retailing industry worldwide and the UK's e-tailing industry is on the cutting edge.

This is a new industry, and it's growing by leaps and bounds. Expertise is in short supply. We are fortunate to have found Sally Bruer, a real estate analyst at Gerald Eve, who has been tracking the progress of the UK's internet retailing industry for a while. She has done an excellent job of describing this dynamic, fluid sales channel and its far-reaching impact on the UK's distribution property markets.

How far will online shopping penetrate the UK's retailing industry? At this point, nobody knows. But virtually everyone concedes that in ten years its penetration will be much greater than it is today. And that means that this industry niche is going to need a lot more warehouse/distribution space.

From the Author

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About ProLogis

ProLogis is the world's largest owner, manager, and developer of distribution facilities, with operations in 105 markets across North America, Europe, and Asia. The company has $34.4 billion of assets owned, managed, and under development, comprising 483 million square feet (45 million square meters) in 2,669 properties as of September 30, 2007. ProLogis' customers include manufacturers, retailers, transportation companies, third-party logistics providers and other enterprises with large-scale distribution needs. Headquartered in Denver, Colorado, ProLogis employs more than 1,300 people worldwide.

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