

EUROPEAN LOGISTICS REPORT - ISSUE 4

E-shaping of the European Logistics Market

Key Takeaways:

- > The e-commerce sector has a direct impact on the logistics market with the introduction of new distribution strategies that are transforming supply chain management and warehouse design.
- > Today's logistics market does not meet the requirements of online retailers as it has been designed to handle large consignments primarily for the B2B sector.
- > There is an opportunity for third party logistics companies to create a full service solution for online retailers and for developers to build warehouses that are designed for these evolving requirements.
- > Western Europe currently has the largest share of the e-commerce market, however, demand in Eastern Europe is growing rapidly with Poland leading the pack.



Without a doubt, online services and e-commerce are two of the most significant innovations in the global economy in recent years and are expected to continue to reshape not only retail trade, but also other sectors, including the commercial property market.

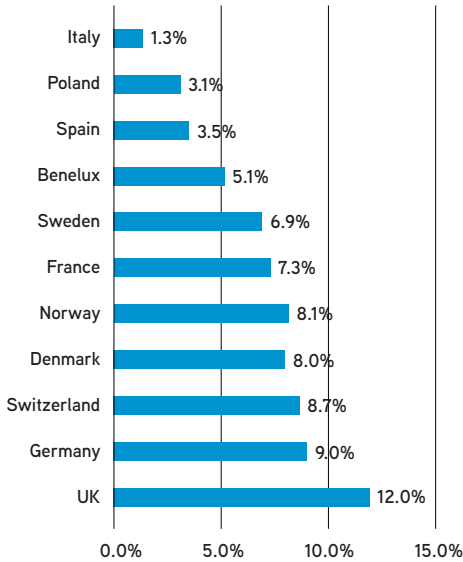
Although online purchases account for only c. 4% of total retail sales in the EU, e-commerce is currently one of the fastest growing markets in Europe and is expected to continue to expand amidst the further development of multi-channel selling offered by bricks-and-mortar retailers and the expansion of 'pure play' online stores.

The European online retail market recorded 18% annual growth and was estimated to be worth €200 billion in 2011. Some 70% of this figure, came from just three countries: Germany, the UK and France. Unsurprisingly, these markets have a large concentration of warehouse space occupied by both traditional retailers selling online and 'pure play' online retailers.

Although Western Europe currently dominates the online market, Eastern Europe is being targeted by large international players due to the fast growth of online sales. Poland was the fastest growing market in all of Europe last year at 34%. This focus on Eastern Europe will reshape the European distribution network of retailers selling through multi-channels.

In this paper, we look at the impact of e-commerce on the European logistics market, the resulting need for alternative warehouse design and new patterns of distribution.

FIGURE 1: SHARE OF ONLINE SALES IN TOTAL RETAIL TRADE 2011



Source: Centre for Retail Research

NEW SOURCE OF DEMAND

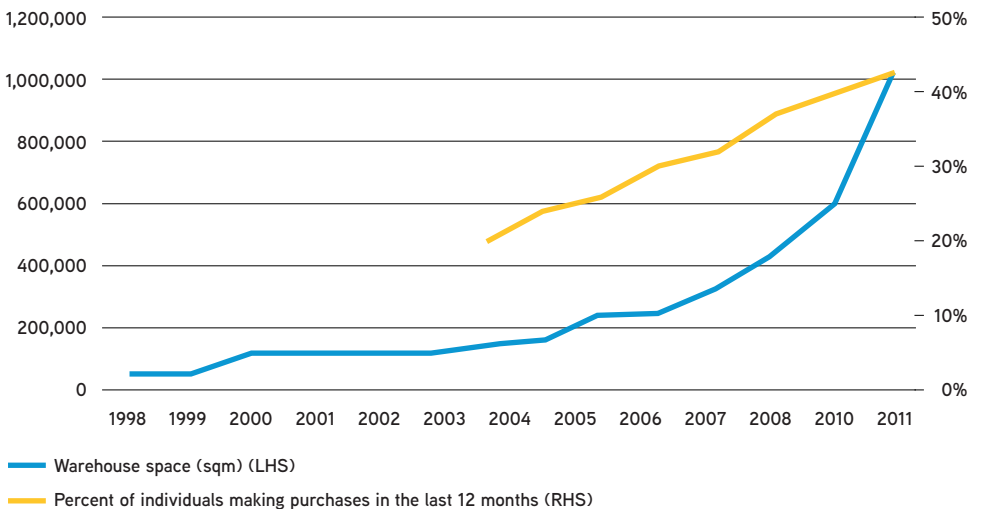
With the online retail market growing rapidly and traditional retailers broadening their sales channels, demand for new warehouse and distribution space is growing swiftly.

One of the most striking examples of how online retail is driving rapid expansion in the European logistics market is Amazon. The company has increased its distribution space in Europe by more than 1000% in the last 10 years and at the end of October 2012 the company occupied more than 1.3 million square metres. The vast majority of this space has been delivered by Goodman, who spotted the potential of the e-commerce sector early and has delivered customised warehousing solutions not only for Amazon, but also for the rising star of the German online market, Zalando.

Although this fashion e-tailer only started its business in 2008, by 2011 it reported annual revenue of €500 million and has expanded its activity to other countries including the Netherlands, France, Italy and the UK, with plans for further expansion. Zalando is growing so fast, that before the completion of a 78,000 sq m warehouse in 2012, the company decided to expand the space to 128,000 sq m. This is hugely impressive growth for a company that only went live four years ago with a limited product range distributed from the office basement.

However, it is worth noting that some of the largest online market players are traditional retailers (e.g. Tesco, M&S, Inditex). With struggling economies impacting upon retail sales across Europe, many bricks and mortar retailers are rebalancing their selling strategies. Store portfolios are being rationalised, with unprofitable stores being closed and more energy being focussed on new sales channels, particularly via the internet and through improved mobile and tablet technology. This is driving demand for more warehouse space. In the UK, John Lewis and Boots opened new warehouses at the beginning of the year to deal with the increasing number of online orders.

FIGURE 2: DISTRIBUTION SPACE OCCUPIED BY AMAZON IN EUROPE VS. E-COMMERCE GROWTH



Source: Colliers International, Eurostat

Improving cross-border sales

- > From 2004 to 2011 the percentage of individuals in the EU who made a purchase online rose from 20% to 43%. However, the number of consumers making cross-border online purchases is still very small (10%).
- > For retailers the main barriers to cross-border e-commerce arise from the fragmentation of consumer protection rules and other rules on VAT, recycling fees and levies.
- > For consumers the barriers to cross-border purchases are uncertainty on their rights, delivery, returns and complaints procedures.
- > The European Commission is determined to eliminate the obstacles standing in the way of further development of e-commerce, especially at cross-border level.
- > The Commission's activities aim for the creation of an internal retail market, greater transparency on companies and prices on the Internet, simplifying the VAT reporting obligations of distance sellers and increasing access to finance for SMEs to encourage innovation.
- > If EU policy can be made effective, it will accelerate the development of online sales and services, resulting in the expansion of appropriate distribution space.

EMERGING DISTRIBUTION SYSTEM

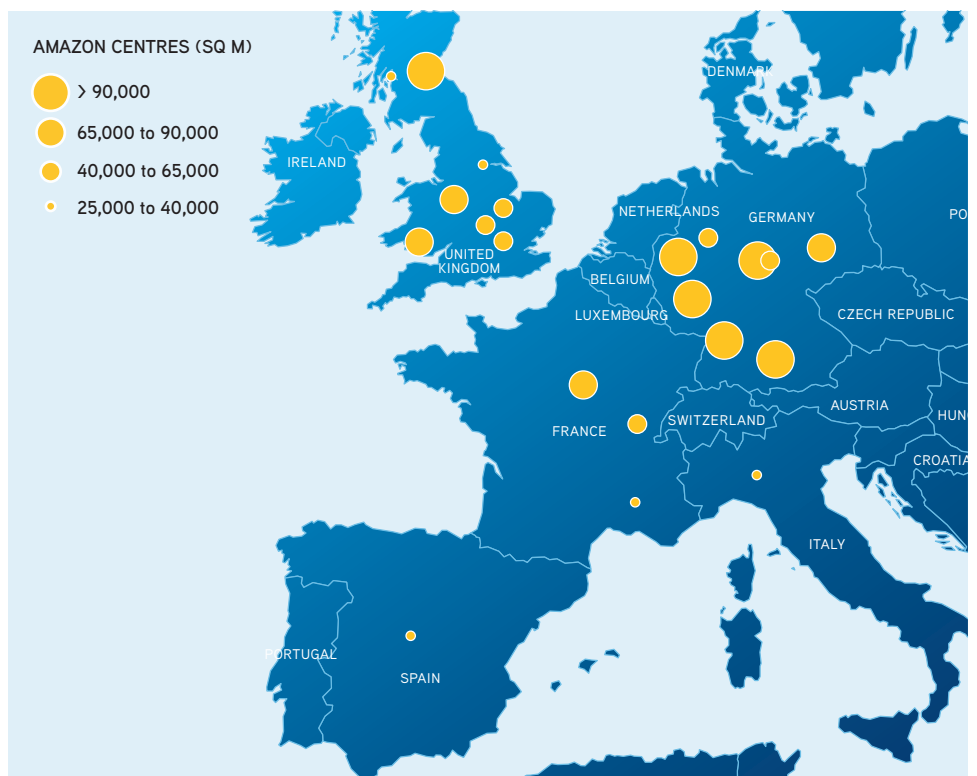
E-retailers require far more complex distribution systems than traditional logistics market players. First of all, the e-commerce business is based on a 'Business to Consumer' (B2C) model. This means that at least one, if not several, intermediaries have been eliminated from the supply chain, increasing the number of customers the e-tailer/warehouse occupier is dealing with into thousands. Further implications include working with multiple suppliers, storage requirements, the distribution of large quantities of small products with short delivery times and the high importance of reverse logistics.

Expansion of this business model has led to the development of e-fulfilment centres, where the whole supply chain is embraced, from obtaining the products from suppliers, through storage, sorting, packing and transfer to carriers, as well as managing the returns.

A typical centre should be able to run the whole process smoothly and efficiently and have a reliable management and order tracking system. What might come as a surprise is that such a complicated distribution and storage system is usually addressed with a very simple, but detailed process. With clearly defined areas for specific activities (see figure 4), the fulfilment process can now be carried out under one roof. As the efficient management of returns plays an important role in e-commerce, a dedicated area for such operations is also defined within the centre.

This is how, for example, Amazon's distribution centres are operating, with a very simple division of warehouse space with different kinds of products stored in different parts of the warehouse. There is little use of high storage space.

FIGURE 3: AMAZON DISTRIBUTION CENTRES IN EUROPE



Source: Colliers International

PEOPLE VS. TECHNOLOGY

- › Large numbers of staff are required to run fulfilment centres and employment costs form a significant proportion of the operational cost of any e-tailer.
- › Because of the size of the Amazon e-fulfilment centres they are generally located where there is easy access to a large labour pool.
- › Providing greater time and cost efficiencies through increased automation is an on-going challenge for e-fulfilment and logistics operators.
- › Currently, the technical solutions for e-fulfilment centres include:
 - Batch and sort picking
 - Single unit pick solutions
 - Barcode scanning
 - Very narrow aisle bulk storage
 - Fully automated picking and packing
 - Goods to man solutions.
- › One of the most interesting solutions in recent years are Kiva Systems' robots, which pick items from shelves or pallets and bring them to packers, increasing picking efficiency. The potential of the Kiva's automated order fulfilment systems has been spotted by Amazon, who bought the company in March 2012.

Traditional bricks and mortar retailers with online sales operations also have unique warehouse requirements. They have the added complication of offering multiple delivery options, ranging from home delivery to in-store pick up, which affects their storage and distribution needs. Many multi-channel retailers are currently transforming their distribution systems in order to achieve higher efficiencies and lower storage costs.

There is no common strategy among online retailers regarding the density and size of their distribution network, even though they have similar warehouse and distribution requirements. While Amazon operates on the basis of large warehouses with an average size of 62,000 sq m, for example, other companies use smaller premises located within urban areas, where not only parcels are sent out, but also where customers can collect their orders.

OPPORTUNITIES FOR THIRD PARTY LOGISTICS (3PL) PROVIDERS

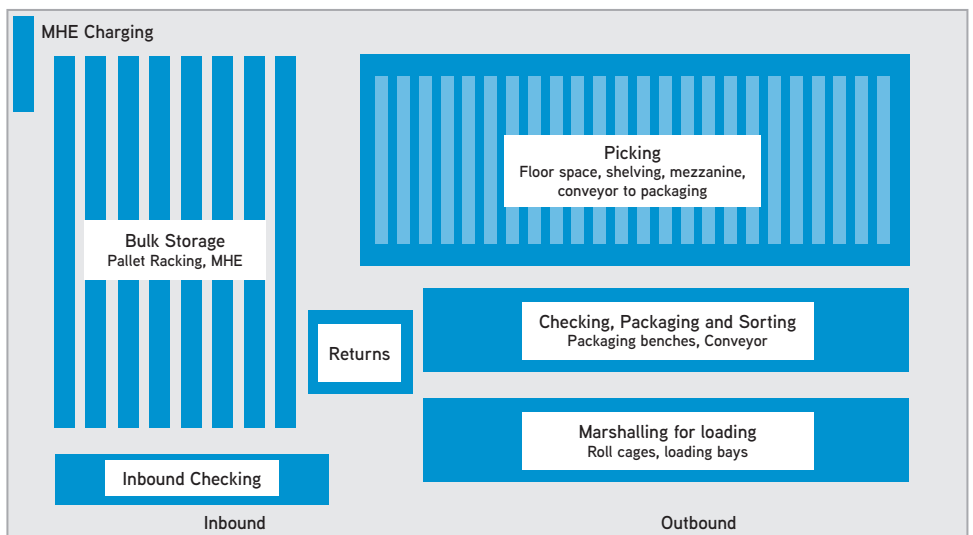
Due to the undeveloped range of services offered by 3PL providers, the relatively complex distribution requirements and the limited supply of warehouse and distribution facilities to meet those needs, a number of retailers with growing online sales are developing their own e-fulfilment centres instead of entrusting them to third party operators.

While the majority of large market players such as Amazon are expected to continue to operate their own fulfilment centres, or even to take over the full supply chain management from their current providers, there are a significant number of companies who would consider outsourcing their supply chain to a 3PL company if their needs could be met. However, many 3PL providers still underestimate the potential of e-commerce and do not offer the full range of services required by online retailers, which is surprising given the fast growth of this sector.

The German 3PL market is leading the pack in providing a full service solution to e-tailers. Fiege has gained some significant clients in recent years including Zalando, Media Saturn Holding and Mexx. Another German-based logistics provider, Hermes, has recently launched a new e-commerce offering and is looking to attract US online retailers who are planning to enter the European market.

As there is no sole distribution strategy among online retailers, the market is ripe with opportunity for third party logistics companies to develop a full range of tailored logistics services, as well as for developers who in turn can provide suitable warehouse premises.

FIGURE 4: TYPICAL FULFILMENT CENTRE LAYOUT



Source: Total Logistics

522 offices in 62 countries on 6 continents

United States: 147
Canada: 37
Latin America: 19
Asia Pacific: 201
EMEA: 118

- €1.3 billion in annual revenue
- 116 million square meters under management
- 12,300 professionals

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CONCLUDING COMMENTS

E-commerce will continue to grow and have a significant impact on the European logistics market, driving demand and reshaping distribution strategies.

While Germany and the UK will remain the top e-tailing markets, the fastest growth will take place in Eastern Europe, with Poland leading the way. Rapidly growing online sales, a large consumer market, access to a relatively cheap labour force and an established logistics market make Poland an exceptionally attractive location for international e-tailers.

Existing online retailers will continually expand their warehouse space in the coming years, while new market players will be searching for suitable facilities and supply chain operators. Increasing demand for appropriate distribution space, as well as tailored logistics services, will put pressure on developers and 3PLs to adjust their offer to meet these new requirements.

In the coming years, we will see both online and multi-channel retailers rethinking their strategies for storing and delivering their products, resulting in continuously changing and evolving warehouse and distribution requirements. Developers and 3PLs who are able to quickly adapt and evolve their offers will be very much in demand. There is already some market evidence of investors focusing their attention towards logistics facilities built and designed with these multi-faceted distributional needs in mind.



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