Research Blast

The logistics of Christmas – January 2020

2019 saw a whole year of declining sales for the first time on record, capping off a bad year for retail.

Nevertheless, online retail now accounts for than a third of non-food sales

But as margins remain under pressure, the fulfilment side of online retail is becoming harder.

Christmas in Europe is increasingly going online – the enduring question is: can distributors cope?

The nature of Christmas shopping is changing with consumers increasingly having presents delivered rather than going out shopping. But it's not Santa and his reindeer bringing the gifts…

2019 was a disappointing year for most of the high street. According to data from the British Retail Consortium, total sales fell for the first time since 1995 by 0.1%. However, online took a larger slice of the pie with the non-food online penetration rate increasing to 34.5% this December (December 2018: 31.2%). This has been a familiar pattern in retail: stagnant in-store sales combined with ever higher levels of online sales. But as consumers shun Christmas shopping in favor of ordering in front of a warm fire (or in the pub), parcel volumes have surged to unprecedentedly high levels.

While this is ostensibly good for retailers and logistics companies, there are clear signs that the distribution side of the equation is coming under pressure. The cost of delivery, returns and logistics has now soared to 75% of costs of the average distributor, raising the question as to whether "eChristmas" will prove viable in the long-run. We have identified five factors that are placing increasing strain on the ecommerce supply chain: *Volume, Fulfilment, Land, Labor and ESG*. Overleaf, we consider the challenges each factor poses, but also potential solutions for operators:

1. Volume

Pre-ecommerce, the average consumer in Germany received 1-2 parcels a year. Fast forward to the present day and this figure has shot up to 24, while the average value per parcel has declined. This has placed immense strain on supply chains, which have struggled to adapt to the new capacity levels. Ever-faster delivery methods also put strain on already stretched margins; as Figure 1 shows.

Volume is difficult to reduce now the genie is out of the bottle. However, consumers are typically not willing to pay for delivery so providing a range of options (such as collect in store) will lower the number of home deliveries. Additionally, a recent survey indicates most European consumers are happy to wait three to five days for their package to arrive, indicating super quick delivery is not essential.

2. Fulfilment

Failed deliveries cost the industry EUR 1.64 billion a year. As a result, drivers are reporting more and more pressure from managers to not return items to the warehouse, while customers are reporting finding packages left in non-secure locations (or simply tossed over the fence). Returns are also expensive with separate warehouse space often required.

In absentia delivery solutions, such as delivery lockers have been used successfully in several European countries. Less-developed but equally powerful are "behind-the-door" solutions, such as Smartlocks. This is a mechanism where customers provide delivery drivers with temporary access to the house, which also has the additional benefit of reduced returns.

3. Land

The cost of leasing assets in urban locations has also gone up significantly. Most major cities (despite the increasing demand) have seen a net loss of industrial land over the past decade. This means urban logistics in most major cities are both expensive and hard to secure for occupiers.

Land issues can also be solved by central and local governments by ensuring there is a cohesive industrial plan protecting urban logistics zones. More urban logistics space can also be added with mixed use developments, so-called beds and sheds, as well as multi-storey warehouses.

4. Labor

Deutsche Post recently estimated that to meet the demands of expected ecommerce eight years from now, 100,000 additional delivery drivers will be required. In fact, driver numbers are falling with many European companies already reporting shortages as fewer younger drivers enter the profession.

The shortfall in human drivers may be offset by robots and driverless cars. Most operators believe drones are still some way off; however, there are already several companies experimenting with delivery robots. Deutsche Post, for instance, is already using a "follow me" delivery robot that can carry heavy loads for the driver.

5. ESG

Finally, there is a significant environmental cost to last mile logistics. Data from the UK indicates that miles recorded by light commercial vehicles have increased by almost 100% over the past 25 years. Several cities have already taken measures to curb the use of polluting vehicles, while political pressure has increased to reduce the emission of greenhouse gases. The more granular nature of ecommerce means a large amount of packaging is used as well.

ESG considerations are a huge challenge, but the impact of the supply chain can be lessened by using green vehicles, such as electric cars and bikes. Technology can also play a role in making routes more efficient; for instance, UPS trialed a scheme where drivers only ever turn with the direction of traffic to avoid burning off fuel by breaking and reaccelerating. Greater efforts to make sure packaging is fully recyclable would also lessen the impact on the environment.

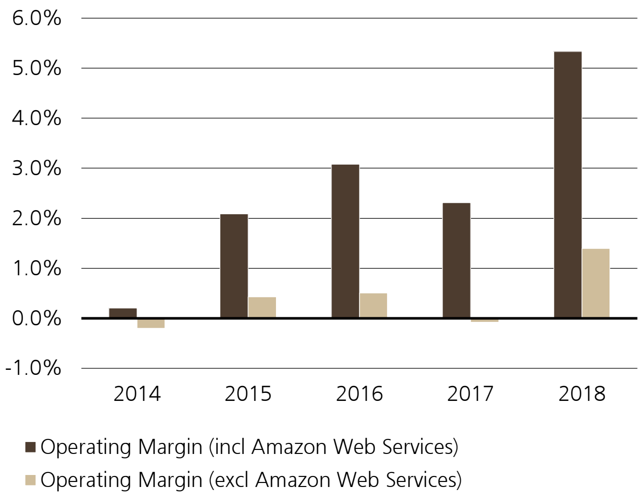
Looking to the future

Ecommerce expansion is likely to be constrained by limits of space, resources and people. But we believe demand will continue to rise, particularly in mainland Europe which remains behind the UK in terms of market penetration. The question is can distributors do this sustainably and profitably; as Figure 2 shows, even Amazon struggles to make money out of the distribution side of their business. This makes the challenge even greater for smaller companies without the same economies of scale.

This is not to say that the last mile delivery model is unsustainable; it is just in its infancy. As the model evolves we will see a greater use of technology, innovation, as well as physical retail space to strike a balance between convenience and efficiency.

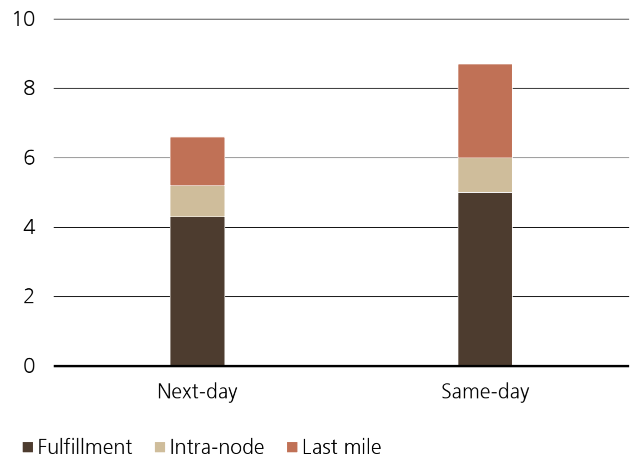
Notwithstanding all the clever technological solutions, the biggest challenge of all will be engaging consumers to think more flexibly about how they shop online. Companies such as John Lewis have already led the way on this, announcing last year they would introduce fees for click and collect orders under GBP 20. At some point operators must pass on the costs of the supply chains to their customers; this could end up being the Grinch that steals Christmas.

Figure 1: Amazon profit margins (%)



Source: Amazon Company accounts, PMA, June 2019

Figure 2: Delivery Cost (EUR per parcel)



Source: Mckinsey, 2019

Real Estate & Private Markets,
Research & Strategy – Europe
Gunnar Herm
Sean Rymell

For more information, please contact:

UBS Asset Management
Real Estate & Private Markets (REPM)
Research & Strategy

Sean Rymell
+44-20-7901 51 02
sean.rymell@ubs.com

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