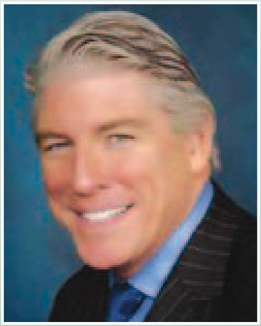
Do Big Retail Companies Still Need Distribution Center Space?

By Paul A. Waters, SIOR, CCIM, CRE, FRICS



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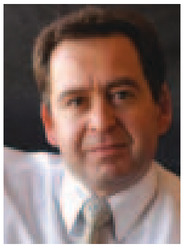
YES. That's the answer in a word. Retail companies still need warehouse space, but we should begin with a discussion of the changing warehouse requirements of retailers. This need for warehousing/distribution space (assuming stores are selling goods and need to be restocked) but will be predicated on the type of business and products the retailer sells. Traditional dry goods retailers, such as Target, Pottery Barn, CVS, and Wal-Mart, continue to rely upon warehouses and distribution centers to maintain inventory levels, but all utilize specific methods relevant to their own business strategies and products. In 2009, American retailers occupied in excess of five billion square feet of warehousing/distribution space. Although significant new leases are way down, retailers do continue to extend and/or renew their lease holdings. Many are attempting to downsize, but all are said to be reviewing their long-term warehousing strategies.

The Wal-Mart Way



Marc Wulfraat, a supply chain and logistics industry expert at Tran-Systems, Montreal, Canada, suggests that to better understand why retailers will still need distribution centers, it may be helpful to understand the distribution strategy of Wal-Mart, indisputably the world's largest and most successful retailer. "At last count," Wulfraat says, "Wal-Mart's U.S. network consisted of 147 large-scale distribution centers, [comprising] flow through general merchandise facilities, grocery distribution centers, fashion/apparel facilities, Sam's Club facilities and dedicated import facilities. Wal-Mart's distribution centers are absolutely massive," he said. "The prototype general merchandise distribution center is 1.2 million square feet, the typical grocery distribution center is 880,000 square feet, and Wal-Mart's

"Virtual" retailers will continue to need distribution and/or fulfillment space.

largest import facility in Texas is 4,000,000 square feet. Most of the distribution centers are an average of 125 to 150 miles from the stores—a huge competitive cost advantage compared to retailers who ship from farther away."

It is generally accepted that the world's largest retailer sets the stage for warehousing strategies. "It is estimated that Wal-Mart self-distributes 85 percent of the cost of goods on their retail shelves as compared to less than 50 percent for their competitors," Wulfraat says. "While Wal-Mart has contracted with third party logistics providers for specific distribution operations, it owns and operates the vast majority of its approximately 120 million square feet of distribution center space in the U.S. In simple terms, Wal-Mart's entire business strategy is based on squeezing out cost across all levels of operations to achieve its low-price competitive advantage. For most retailers, logistics represents one of the largest controllable expenses on the income statement and Wal-Mart's distribution efficiencies quite simply are at the heart of why this company has grown to $405 billion since the first Walton's five and dime was opened in 1962."

Evolving Distribution Center/Fulfillment Strategies

Retailers of bulk items, such as furniture, appliances, other household items, will continue to need warehouse space. Some deploy a drop ship strategy that is self-operated and use third party logistics firms (3PLs), but in more robust climes, inventory is turning over and sales floors need replenishment. Appliance and furniture retailers typically utilize a "floor model"-only strategy. Using high-tech communication systems, fulfillment distribution centers are instructed to deliver and restock as items are sold. Most of these same retailers lease some additional "warehouse" space within the retail shell to store high-volume SKVs, such as hand-carried products that have historically sold well and need immediate replenishment. But the additional space is not likely to be enough to reduce centralized distribution center requirements.

Some discount stores, such as the "dollar stores," are experiencing steady sales volumes for obvious reasons. Customers are leaning on them as they re-engineer their lifestyles and purchasing habits. Many of these discounters sell SKUs of small items, such as toothpaste, shampoo and soap. These goods need to be replenished often, daily perhaps, and the items need to be stored in a favorable location.

The need for distribution center facilities is directly related to the type of product(s) sold. Turnover of product SKUs and restocking requirements will ultimately define the warehousing strategy. Calibrated correctly, calculating square footage will be a simple metric exercise. If short-term and long-term distribution strategies are not professionally determined and leveraged against best practices, spikes in demand will create expensive and disruptive challenges to the retailer.

"There will always be a need to store goods prior their ultimate distribution to retailers," says Joseph Trinkle, Vice President of Liberty Property Trust, Houston, Texas. "However," he says, "many of the large retailers have pushed the obligation/burden of storing those goods (as well as the timeframe of ownership) onto the manufacturer. They do this because they can. The effect, of course, is that these retailers need less warehouse space for their goods even though the amount of warehouse space that is ultimately needed in gross terms has not changed.

"Other retailers have chosen to adjust their strategies and create more numerous but slightly smaller warehouses that are located closer to their stores." Trinkle explains. By locating their warehouses and stores more closely, they minimize the need to maintain inventory at the retail location, as goods can be quickly restocked from the geographically favorable warehouses. In so doing, they shift the need to store inventory at the store (at $50 per sq. ft.) to that of the warehouse (at $4.50 per sq. ft. plus transportation)."

Trinkle adds that many of the distribution centers that are being leased closer to stores have installed automation processes that allow for rapid deployment of inventory to the stores. For instance, one DIY chain rolled out this type of program; with a 'prototype' facility and process they named 'Rapid Deployment Center'."

In short, he agrees, "Retailers will always need warehouse space [although some] have shifted the need for warehouse space to third parties."

E-commerce Still Needs Physical Space

It's important to recognize that possibly the fastest growing segment of the retail industry is online retailing. However, these "virtual" retailers will continue to need distribution and/or fulfillment space. So-called "brick and mortar" stores require buildings—a physical presence—for their operations, offering face-to-face customer experiences. Online stores, in contrast, have no physical presence. But e-commerce still needs warehouse/fulfillment space. Many virtual retailers also rely upon the logistics vendors to act as 3PLs, further evidence that four walls and a roof will remain paramount to servicing the retail industry.

In brief, retail companies still need warehouse space, third party providers still need warehouse space, and Internet purveyors still need warehouse space. I suppose that's a good thing from our perspective as requirements are the fuel that provides the traction that provides the commissions.