

OMNICHANNEL LOGISTICS COUNTERING AMAZON

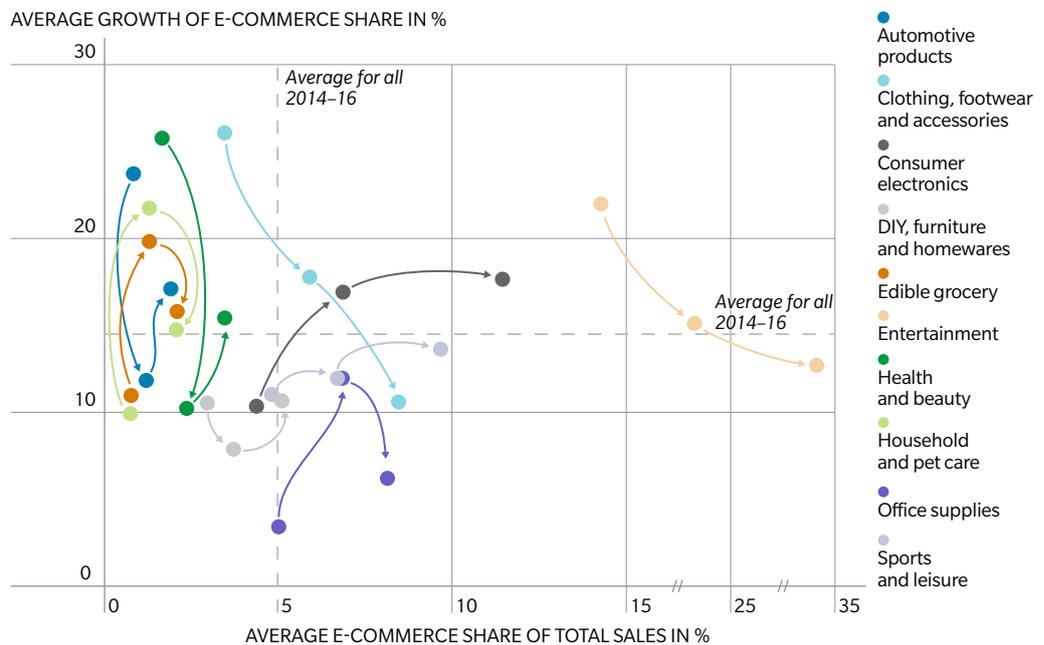


OMNICHANNEL LOGISTICS

Now in its teenage years, e-commerce continues to barrel along a path of exponential growth, finding new ways to reach shoppers and expanding into new retail market segments. Amazon is the most important member of the e-commerce vanguard from a logistics perspective, as it regularly drives the bar higher for customer convenience. In addition, a plethora of other pure online retailers are breaking records for e-commerce growth and market penetration.

It's important however to realize that different parts of the online market are maturing at different rates. This can help retailers develop the right products and better predict specific market demand and growth. While some segments such as consumer electronics and sports/leisure are still in a rapid growth phase, other e-commerce segments such as entertainment and clothing are approaching maturity and losing momentum. Given its online share of sales, this is not surprising for entertainment. For the clothing category, both touch and feel and emotional connection are still important criteria. Still up for grabs in e-commerce are relatively novel segments such as edible grocery, automotive products, and household/pet care. These segments are still in their infancy but break-through changes in fulfillment and delivery processes and assets might likely result in industry disruption and a bump in growth rates.

Exhibit 1: E-commerce market dynamics, 2008 – 2016 (European Union)
Averages for 2008 – 2010, 2011 – 2013, and 2014 – 2016

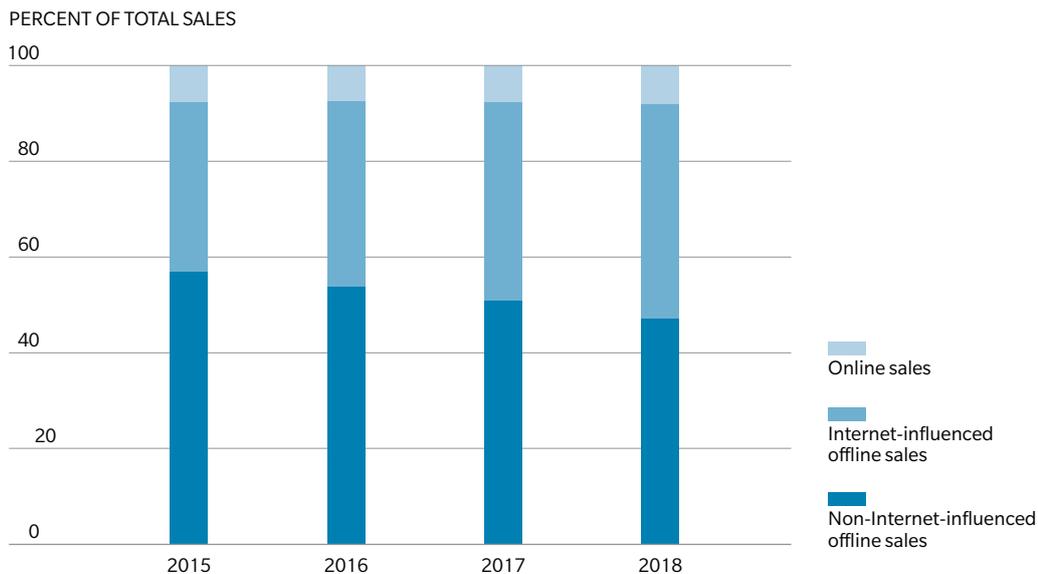


Source: Oliver Wyman analysis, based on data from Planet Retail

While expectations are that future growth in retail will be dominated by online offers, clearly it's too early to hold a requiem for traditional stores. In particular, brick-and-mortar retailers have access to powerful online-plus-offline options that can be paired up to deliver a strong "omnichannel" counter to e-commerce pure plays. The value of this strategy is clear.

By 2018, 44 percent of total retail sales in Europe, for example, will be Internet-influenced offline sales (see Exhibit 2). Mastering omnichannel, however, means developing strategies that will capture customers at the point of purchase – or else stores risk becoming offline research venues for Amazon purchasing.

Exhibit 2: Forecast of European cross-channel retail sales, 2015 – 2018



- *Internet-influenced offline sales*: purchase completed in a physical store following some level of online research pre-purchase
- *Online sales*: financial commitment to purchase is made online (even if pickup is made in store)
- *Non-Internet-influenced offline sales*: purchase completed in a physical store without previous online research

Source: "European cross-channel retail sales forecast, 2013 to 2018" Forrester Research, April 2014.

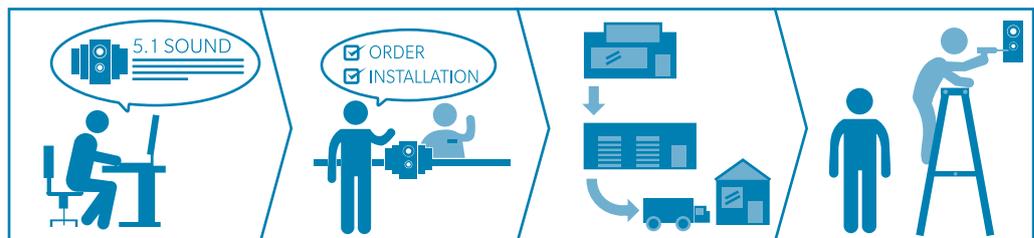
Becoming an omnichannel retailer means picking up on the key shift in consumer behavior of this decade: Consumers increasingly expect to discover, search, buy, pick up, and return items seamlessly from an array of physical and digital access points.¹ Taking advantage of this shift requires a number of specific cross-channel activities, built around an understanding of how best to leverage customers' purchasing "journeys" as they travel between online and offline shopping spaces. It's not enough however to change stores and product/service offers: Driving a successful omnichannel operation requires a powerful engine: a sophisticated set of logistics and supply chain capabilities that reach across all organizational levels.

¹ For more on omnichannel retail, see also: "Omnichannel Operations: Two Steps to Survive and Win" (http://www.oliverwyman.com/insights/publications/2015/apr/omnichannel_operations_two_steps_to_survive_and_win.html).

REMAPPING RETAIL OPTIONS

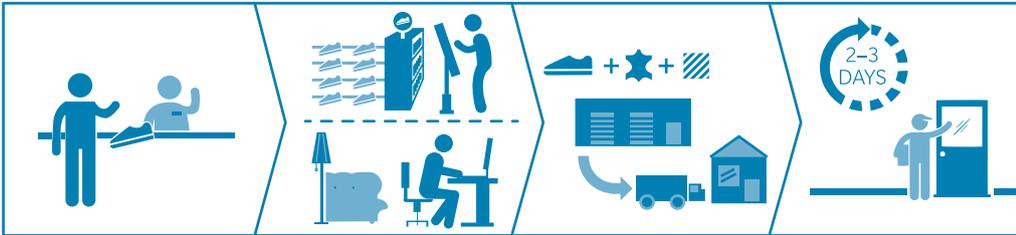
A move into omnichannel retail requires understanding how customers use various channels, particularly to solve problems or avoid hassles. As the examples below and on the next page demonstrate, customer shopping journeys can be multifaceted. An omnichannel retailer understands that customers expect access to a retailer's products 24/7. Various online-to-offline and offline-to-online options can then increase customers' ease of use and convenience when it comes to purchasing, especially of non-commodity goods, and add value beyond what either a pure play or brick-and-mortar experience can deliver. Two messages are thus clear at this point on how stores can counter Amazon. They can either: 1) increase product experience and access beyond pure online; or 2) focus on non-commodity products, i.e., individualized products, sets, and bundles.

EXAMPLE 1: BUYING A SOUND SYSTEM ONLINE SEARCH FOLLOWED BY OFFLINE TESTING EXPERIENCE



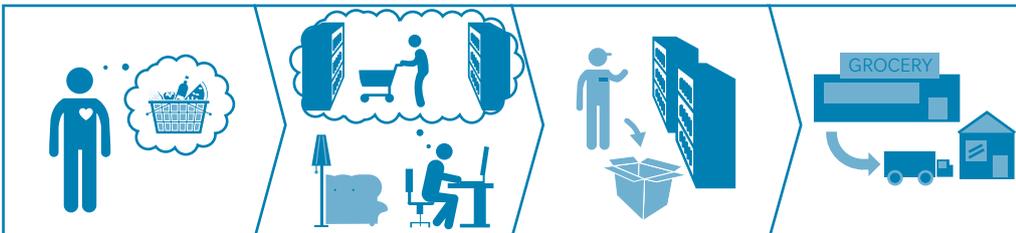
The ability to capture customers' choices and desires online and then offer a true touch and feel experience before purchasing is a strong asset for an omnichannel retailer. Many stores are becoming showrooms for non-perishable goods such as electronics, meaning that local shops' "my own stock" paradigms must be unlearned. Stock is kept instead at centrally located warehouses, and replenishment of stores is replaced by fast, agile pick and pack and parcelization at a fulfillment center. Powerful IT integrating online and offline logistics and providing real-time visibility into inventory is important, as is local availability of support functions, such as installation and servicing.

EXAMPLE 2: BUYING CUSTOM SHOES OFFLINE TESTING FOLLOWED BY ONLINE CUSTOMIZATION AND PURCHASING



Omnichannel retailers also can take advantage of the reverse of the process described in Example 1, by giving customers the chance to first physically test products, see options, and build an emotional connection to an item, then go online (either in store or at home) to customize the product and have it shipped directly to the home. From a logistics perspective, this raises the question of where to perform value-added services such as product customization. Tailoring in Asia during the regular production process might be cost efficient, but often is unacceptable to customers due to long lead times. Near-shoring of production in its entirety or of customization steps are options worth considering.

EXAMPLE 3: FRESH GROCERY LEVERAGING A TRUSTED BRAND AND HIGH-QUALITY PRODUCTS TO LEAD THE ONLINE MIGRATION



Fresh grocery is the biggest untapped market for e-commerce at present, as most potential customers do not yet trust online companies to provide the desired quality in a convenient way. Offline grocery retailers thus have a great chance to become true omnichannel players by filling this gap, as they can leverage their emotionally connected and trusted brands to win the hearts and minds of customers through superior quality and the availability of regional products. From a logistics perspective, this requires local distribution centers or dark stores to enable efficient fulfillment and delivery to dense urban areas and convenient pick-up locations.

All three examples above showcase opportunities for retailers to build stronger connections between offline and online and solve customer purchasing challenges. But rethinking channels, product offers, and store formats won't matter if the logistics backbone is not organized to ensure that the right products, at the right cost, are at the right place – the first time and every time.

The challenges of an efficient logistics backbone are manifold. Consider for a start a few questions that must be answered along the road to an omnichannel presence:

- Which goods should be stored close to/in offline stores, in central/regional warehouses, or made to order?
- Does the same logic apply for fresh, fashion, and furniture and appliances?
- Should replenishment or online fulfillment dictate production location options?
- Should there (still) be central stocks with deep pockets for slow-moving SKUs?
- Should inventory float locally between stores or between warehouses?
- How should offline returns be managed?

The right answers to these and other questions will depend on the desired front line experience for the customer. For example, addressing “I want the cheapest product” will require a completely different supply chain setup than “I want customization,” or “I need same-day delivery and installation.” Hence, it is crucial for omnichannel retailers to understand when and why customers would choose a particular offer, develop a transparent view of the underlying business case, and build a supporting supply chain. The message is simple: Don't complain about Amazon and the other e-commerce giants, if your house isn't in order first.

This also means going beyond what is still the norm at many brick-and-mortar-focused retailers: setting up a Web shop with a separate inventory as an add-on to the traditional offline footprint. Retail website IT and logistics back-ends often manifest performance and cost disadvantages; even worse, they fall behind the streamlined fulfillment and logistics machines of pure online players. The result is that the retailer fails to unlock the revenue potential that could be realized by fulfilling the demands of customers who use multiple channels for shopping – customers that studies show purchase more often and spend a larger share of wallet than single-channel customers.

PINPOINTING LOGISTICS REQUIREMENTS

Logistics and supply chain solutions to support omnichannel retail will to some extent be company-specific. But Oliver Wyman believes there are elements all companies should consider.

First, a retailer must determine what customer purchasing journeys it wants to fulfill – or not. This requires building distinct and transparent business cases for each possible offline plus online option, including understanding exactly how the supply chain must be set up to guarantee maximum convenience for customers while ensuring cost efficiency for the company.

Furthermore, delivering on the omnichannel promise requires close alignment between products and the underlying supply chain and logistics concept. Supply chain requirements to support customer expectations across all channels and each product's entire life cycle must be mapped – from customization, delivery, and installation, to after-sales support, returns, and upgrade options.

Once the supply chain implications for both purchasing journeys and products are fully understood, the retailer is then in a position to develop an integrated logistics and fulfillment concept. This concept must focus on brilliant execution across five key elements:

- **How will goods flow to the customer – and back?** The retailer must be able to predict when and where customers are likely to want which goods, as well as how they are likely to return them. Omnichannel retailers can realize a high degree of differentiation versus pure e-commerce companies by leveraging their existing offline footprint and complementing it with last-mile innovations around predictability, speed, location, and real-time flexibility. Examples of such innovations include “drop in” availability, “click and collect” pickups/returns, and live rerouting of deliveries.
- **How will replenishment/fulfillment be handled?** Analyses show that the operating cost for handling online items can range from 60 to 120 percent compared to offline items. Thus whether and how to integrate offline/online fulfillment must be carefully evaluated from a cost and efficiency standpoint. For example, a merged, regional online-offline warehouse might be highly suitable for a retailer of hanging textiles (especially given increasing same-day delivery demand). But this would not be the case for food or even fresh grocery retail, where offline replenishment mostly requires bulk logistics instead of single item picking and fulfillment.
- **How much inventory to hold – and where?** While inventory concepts are a standard supply chain optimization question, omnichannel retailers must be able to cope with increased complexities, such as a potentially broader range of stock, additional ordering paths, and inventory floating opportunities. On the other hand, if the initial logistics set-up is well thought out, overall inventory levels often can be significantly reduced through pooling and multiple levels of fulfillment/replenishment.
- **What value-added services will the supply chain support?** The omnichannel retailer must determine what value-added services will make its product offerings sing and how/ when to include them in the manufacturing/fulfillment process. For example, for a product with customization options, should the customization be done at the manufacturer, at the warehouse/fulfillment center, or outsourced to a third-party provider?
- **What IT solutions will be required?** Efficient omnichannel operations require integrated online and offline inventory management systems and new capabilities around forecasting online demand, as well as integrated offline/online working capital management. In addition, providing real-time visibility on (local) product availability for customers is a must to unlock omnichannel-specific purchasing journeys.

MOVING BEYOND AMAZON

Oliver Wyman believes that brick-and-mortar retailers have an opportunity not only to counter Amazon and other e-commerce pure plays but to attract customers through more innovative ways to shop. Traditional retailers stand to gain exceptional and lasting value by developing an omnichannel presence, one that plays to their real-world strengths while capitalizing on evolving customer shopping behaviors, backed up by a supply chain and logistics concept that ensure flawless execution.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across 26 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,700 professionals help clients optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com. Follow Oliver Wyman on Twitter @OliverWyman.

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