A White Paper from the North American
Leader in Supply Chain Management



E-Commerce & Multi-Channel Fulfillment:

SUPPLY CHAIN FLEXIBILITY KEY TO MEETING CHANGING DEMANDS

OVERVIEW

FLEXIBILITY MAKES THE SALE

The modern e-commerce retail world creates a paradox for supply chain professionals – how to do more with less. Infinite choices and fast, free delivery may be what the customer expects from an online retail experience, but the infrastructure required to create the ultimate in convenience comes at a high price for retailers.

Further complicating the matter, the struggle to balance customer service and cost is set against a background of economic uncertainty. For example, December 2011 retail sales in North America reached their highest levels since 2007 (driven, in part, to widespread discounting and promotional offers) while some major retailers reported disappointing figures for the same period.

Due to the rapid increase in online sales, many retailers are outgrowing their supply chain infrastructure, forcing a decision of how and where to invest. Because of this unique interaction of e-commerce expectations, rapid growth and financial uncertainty, the challenge of building flexibility into the retail supply chain structure is now more complex than ever. In the end, solving for these challenges will be the key to success.

To assess priorities and concerns in this difficult environment, Exel interviewed e-commerce and multi-channel retailers. This report summarizes the insights and observations gained through this research, and suggests potential solutions that can lead to a competitive advantage.



FLEXIBILITY TO MEET CONSUMER EXPECTATIONS

In the e-commerce world, the modern consumer has high expectations for service, delivery and brand experience. What's more, these expectations continue to increase each year as new technologies and innovative service offerings emerge to raise the benchmark.

Today, a typical American consumer expects: cross-channel services such as "click-and-collect" and "order-to-deliver"; wider online SKU offerings; in-store kiosks; consistent brand experience across the bricks and mortar and online storefronts; free delivery; free returns through any channel; a mobile retail site; etc.

Of these expectations, the consumer demand for free and fast delivery is causing supply chain managers the biggest headache. However, this is one area retailers stated they were willing to invest in because it touches the customer.

FLEXIBILITY TO DEAL WITH DEMAND VOLATILITY

In spite of favorable 2011 peak season sales, ongoing economic uncertainty has a direct correlation to the unpredictability of consumer demand. Retailers are worried about the sudden dips in spending confidence that negative media coverage can create, especially because these market dips are impossible to predict months in advance (when offshore manufacturing plans are made) and are costly to mitigate.

Added to this are the known challenges of providing capacity for peak season sales, which are less predictable than in the past – particularly for the U.S. consumer online channel.

Forecasting unpredictability necessitates supply chain agility, which requires investing in distribution systems and networks. However, retailers are focused on reducing warehousing and transportation costs wherever possible to support profitability.

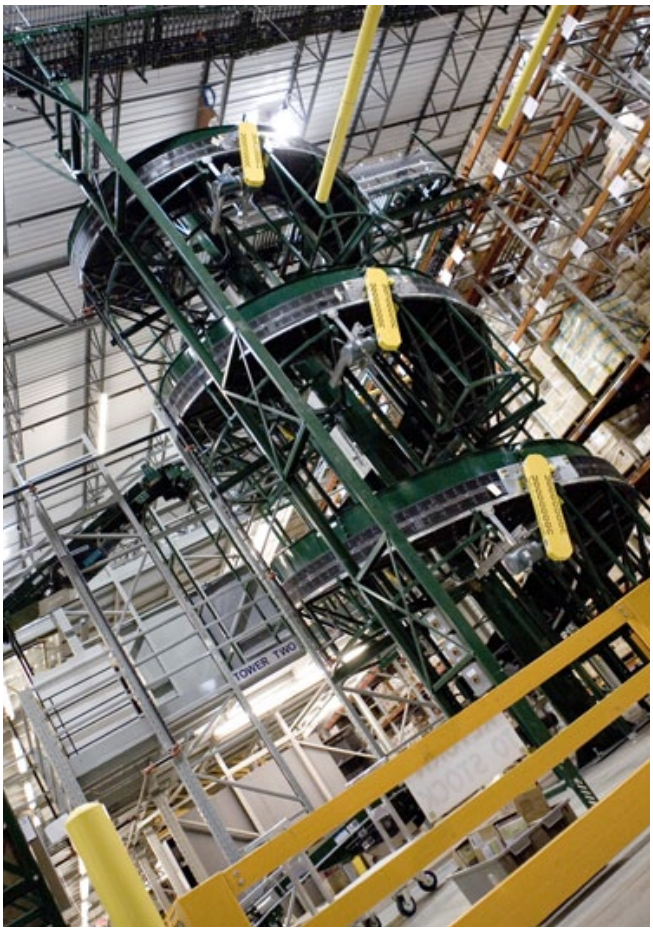
FLEXIBILITY TO SUPPORT A DYNAMIC RETAIL PARADIGM

For many supply chain professionals in the retail sector, the goal posts are constantly shifting as their companies evolve. Traditional retailers are increasingly embracing e-commerce channels and seeking ways to better integrate them with their bricks and mortar channels for a seamless consumer experience. The challenge is both of these trends require changes to supply chain systems, distribution networks and processes.

Meanwhile, despite the economic environment, the retailers participating in the research study were all focused on growth, whether through one channel or overall sales, exacerbating the pace of change and creating fluidity in inventory levels over time.

ABOVE ALL, COST

In conflict with each of these factors, all participants reported that the reduction or control of supply chain costs continues to be a central priority for retailers. Genuine concerns about the rising cost of fuel will only serve to heighten this prioritization in the future.



"Supply chains are costs. As we look at building the next generation, we need to be as efficient as possible; everything we spend comes off the bottom line."

Director of Domestic Fulfillment,
national multi-channel retailer

LOOKING TO THE FUTURE

While many of the factors that drive this need for flexibility are likely to remain for a long time, there are a number of steps that retailers can take to ensure that, in the future, they are in control of and leveraging flexibility for competitive advantage.

KEEPING THE CUSTOMER HAPPY

MORE FOR LESS: E-RETAIL NORMS CREATE PAIN IN THE SUPPLY CHAIN

Retailers in the e-commerce channel that were interviewed stated they are wrestling with the challenges of providing consumers with ever-more-rapid delivery of orders, while at the same time responding to an expectation from those same consumers for free deliveries.

> "The number one priority is maintaining high customer service levels through quick delivery to our customers, while at the same time maintaining free or near-free shipping and handling to remain competitive."
>
> Director of E-Commerce,
> global multi-channel retailer

These drivers are diametrically opposed – requiring retailers to provide more for less – but successful innovation in reducing delivery times or offering free services can differentiate a brand and lead to higher sales. Failure to meet a perceived industry standard, on the other hand, will negatively impact sales.

> "Our promise for a ground order is anything up to 10 days, but the customer is not expecting it to take 10 days. They're expecting it to take 2-3 days, regardless of what we promise."
>
> Director of E-Commerce,
> global multi-channel retailer

Many times these issues are felt more deeply by the multi-channel retailers than the pureplays as their supply chain processes tend to be less aligned with the marketing norms for the e-commerce channel,e.g., they started out focused on store replenishment and need time to adapt. However, multi-channel retailers tend, by definition, to have access to more distribution facilities, which allows them some built-in flexibility around where to locate stock.

SOLVING THE CHALLENGE

There are two approaches that can help retail supply chains reduce delivery times.

Process mapping of the order cycle should be the starting point for any delivery time initiative as it can offer time efficiencies without long-term investment. By looking at each element in the process, from staff scheduling to cut-off times, retailers can literally remove days from their order cycle time.

> "In some cases, multi-channel retailers view the e-commerce channel as just another store, and in doing so, lump it in with their bricks and mortar processes in terms of cut-off times and order processing. This is where we see big areas of opportunities for improvement."
>
> Andrew Alles, Exel Supply Chain





The other option is simply to put more distribution nodes in the network, which requires significant upfront capital investment. Such decisions need to be based on a sensible assessment of the cost versus service-level increase, sales uplift and transportation savings. However, making this investment will ultimately give retailers more flexibility to fulfill orders in the long term.

MULTIPLE CHANNELS, ONE EXPERIENCE

Retailers recognize that the changing ways in which consumers interact across the different channels presents both opportunities and risks. Getting to grips with the logistical demands of meeting expectations for click-and-collect, order-to-deliver and other cross-channel services is an immediate concern for supply chain teams.

Among the concerns raised, aligning the supply chain to fulfill to stores, managing in-store inventory and upgrading or integrating systems are high priorities for retailers.

> "People want to shop on a handheld – to make a dotcom order, but pick it up in a different place. They don't want it at their home; they want it at a store. Or, they want it tomorrow. So we're trying to make our supply chain such that we can fulflll any customer need out of any facility – whether that's a store or a DC."
>
> Director of Domestic Fulfillment,
> national multi-channel retailer

One challenge retailers face is that no industry standard has emerged for the suite of cross-channel services they should offer. While this means innovators in this space can achieve differentiation, laggards may struggle to identify how best to meet and anticipate customer needs.

"The [trend for] Internet and multi-channel retailing [giving] an individual customer the ability to truly get the item or product that they are looking for any time, any where, any place is only going to increase in importance. Every retailer has to figure out how best to provide that service offering or risk minimizing growth potential and, in the worst case, alienating customers, losing market share and eventually going out of business."

Director of IT and Supply Chain,
consumer product manufacturer

The cross-channel services issue is again driven by the raised expectations of the consumer – in this case for a seamless brand experience, regardless of the channel.

In terms of defining what cross-channel services to offer, leading retailers are thinking creatively about how that brand experience can transfer between channels in both directions, e.g., by offering an "also bought" recommendation service in-store. From a supply chain perspective, retailers must consider how the processes that support customer satisfaction in one channel would translate to other channels and how system integration can support a seamless data experience.

Consumers' raised expectations even have implications for the traditional fulfillment of bricks and mortar stores. Retailers participating in the research for this report disclosed an increased focus on store replenishment, putting pressure on supply chains to find the balance between regularity of replenishment (e.g., smaller, more frequent orders), and sending those orders in sufficient volumes to justify the cost.

SOLVING THE CHALLENGE

The challenge at the supply chain level for providing cross-channel services is literally how and where integration between two separate processes should take place. Key to solving this issue is having the visibility and business intelligence tools necessary to coordinate the interaction. So, for example, sophisticated order management systems need to replace manual processes.

In order to define how those systems should work, existing processes need to be mapped and aligned with the new services to ensure that cross-channel services can be performed efficiently and at a consistent cost.



NEGOTIATING PEAKS AND VALLEYS

AGILITY IS MANDATORY

Study participants repeatedly revealed that volatility in demand caused by the fragile economic situation is a serious issue for them. Although many retailers are trying to find ways to make incremental improvements to their forecasting, responding to the element of demand that cannot be predicted is an area that offers an opportunity for real gains (and, by implication, actual losses). Getting it right means meeting customer expectations and growing market share. Getting it wrong means either costly excess stock or missed sales.

> "With the volatility in consumer confidence in purchasing, it's almost feast or famine in terms of being able to accurately predict demand."
>
> Director of IT and Supply Chain,
> consumer product manufacturer

The lengthy time delay from when forecasts are made (to support overseas manufacturing models) combined with the rapid shifts in consumer confidence means that supply chain agility is more important than ever.

In contrast, retailers are confident about their abilities to manage the known, regular peaks in demand (e.g., around holidays). Retailers employ a number of different strategies to handle the larger volumes, and their year-on-year learnings help foster a sense of security.

> "We've been doing it for a while. We have accurate forecasting down to the demand level on a weekly basis; the buildings are designed to handle the volumes, and we build staffing models and training models to meet those plans. It's a regular occurrence that we do every year."
>
> Director of E-Commerce,
> global multi-channel retailer

However, there is a tension that results from running distribution systems that essentially operate in two distinct states, either at-peak or off-peak. The strategies designed to cope with peak – whether that be running under capacity for 10 months of the year or adding additional capacity at a high cost for two months – inevitably incorporate some inefficiencies that retailers may ignore because it's the way it's always been done.

Furthermore, for some the demand uncertainty associated with the turbulent economy is a particular fear during peak season, when fluctuations are magnified and spare capacity is in short supply.

> "You see articles all over saying it's going to be a soft holiday, an ok holiday, a good holiday … it's challenging because you don't know. The biggest problem is always the consumer. There's a high degree of flex. Facilities are busy at this time of year, equipment is hard to get on the trucking side, and we need to be prudent with whatever we've got."
>
> Director of Domestic Fulfillment,
> national multi-channel retailer

SOLVING THE CHALLENGE

From an agility point of view, there are two situations to manage. The first is over-stocking and determining how to best "sell through" the product. Through intelligent discounting retailers can minimize the risk of being left with unsaleable product, but this requires accurate and timely visibility of a range of volume measures. Relevant supply chain metrics include returns, inventory, fill rate, days-on-hand, etc., – all of which need to be integrated with marketing and sales data.

"It requires complete collaboration in a retailer's organization. They can't operate in silos from a sales and operations planning perspective; each one of them impacts one another. A retailer needs to be completely aligned with planning and forecasting and have the ability to execute on those forecasts."

Jeff Francisco, Exel Supply Chain



The second "agility" situation is under-stocking, where costly air freight remains the only way of expediting the transportation process. However, through improvements to the forecasting and sell-through processes above, the threat of under-stocking can be reduced.

In terms of providing smarter peak-time delivery there are two stages to the solution. The first is to robustly challenge the assumption that coping with peak volumes is the same as excelling in that regard. In the second stage, retailers must seek collaborative opportunities with other retailers to share the impact of inventory, equipment, labor and distribution capacity fluctuations – e.g., by partnering with a counter-seasonal product.

Third party logistics companies can facilitate such collaboration by providing access to campus-based assets.

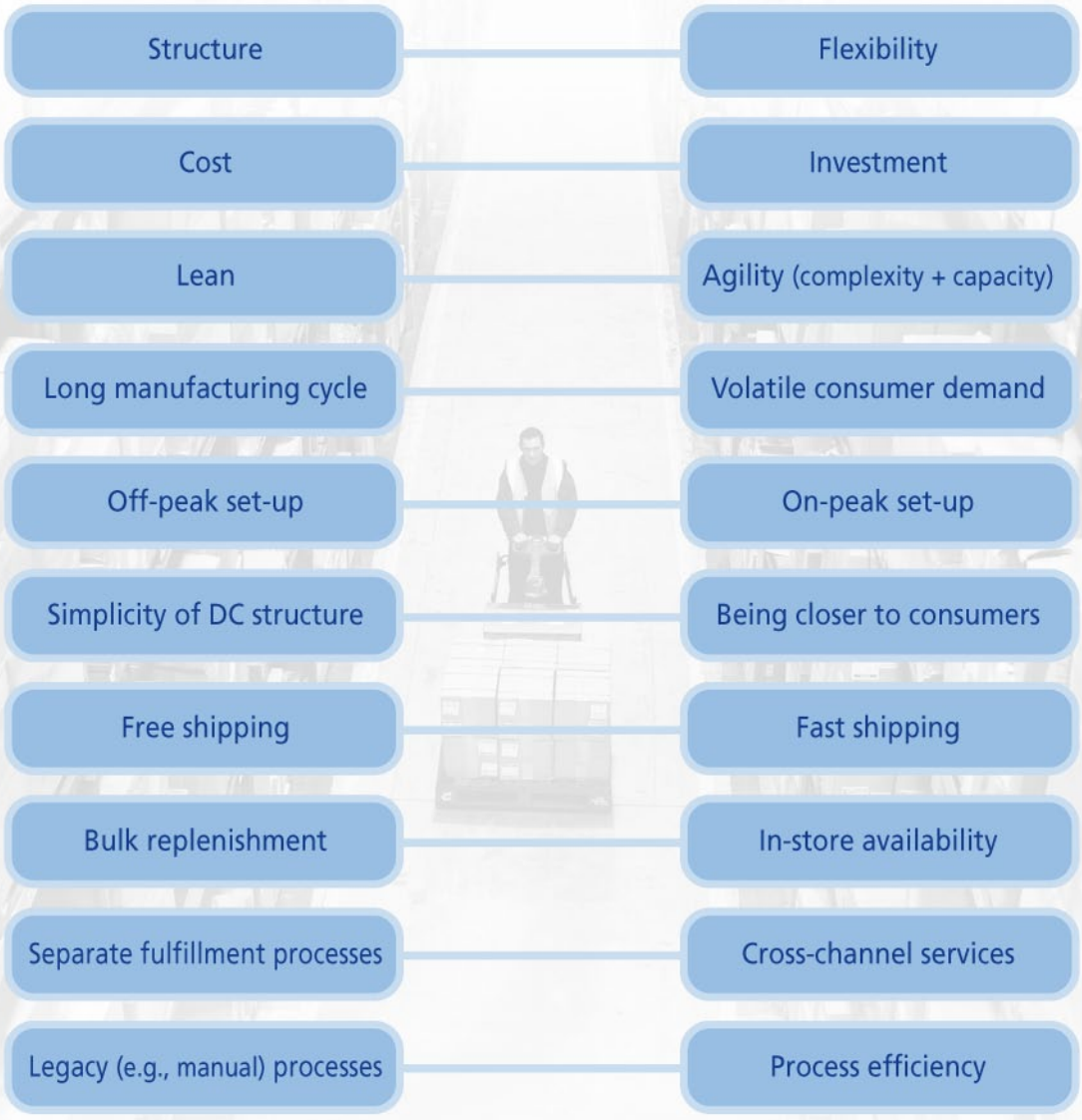
"Retailers who have their supply chain built to deliver peak tend to feel prepared for it. However, they can be challenged to handle off-peak from a utilization and cost leverage perspective … we seek to understand where that extra capacity is, whether it's in inventory or labor or elsewhere – and try to find compatible customers that can use some of the capacity to decrease off-peak costs."

Dan McNutt, Exel Supply Chain

Campus Operations

A typical campus site operated by a Third Party Logistics (3PL) provider encompasses numerous facilities that offer dedicated and shared-use space. Located near intermodal hubs and staffed with administrative as well as facility support personnel, these sites offer a full range of transportation, warehousing and value-added services to multiple customers.

Figure 1: The Balancing Act – the job of a retail supply chain professional is to find the right balance on a range of dilemmas, which broadly equate to locating the point of equilibrium between meeting consumer expectations and controlling costs, or finding flexibility within a structure.



FINDING A FLEXIBLE STRUCTURE



SYMBIOTIC GROWTH

Despite the current economic conditions, retailers participating in this research were focused on a growth strategy. As part of their long-term plans for the supply chain, all were considering adding more warehousing and distribution capacity, albeit the specific needs varied between different types of retailers.

As they grow and change to meet new consumer demands, retailers have the opportunity to redesign their supply chains to meet the challenges of today and anticipate those of the future. As this study reveals, retailers need to find ways to build flexibility into their structures and processes. Increasing capacity not only offers the opportunity to get closer to the consumer, but also supports agility to react to demand fluctuations.

Making the decision about how, when and where to invest is a tricky one and needs to be based upon an assessment of the entire enterprise's needs and goals. The focus on controlling costs that dominates supply chain thinking can hold retailers back from making the plunge.

> "We're always thinking about [how] to get closer to the customer. We only have one DC now, but there's the expense of creating another DC versus holding inventory in two places to decrease transit time. There are more (cost) challenges in holding inventory in separate places."
>
> Director of Supply Chain Strategy,
> high-end fashion retailer

Retailers may take advantage of shared-use facilities to assist with elements of their growth, e.g., when entering new channels and new countries. However, when volumes get large enough, retailers tend to prefer dedicated infrastructure, facilities and people.

"We use labor sharing at a couple of places, but total shared facilities, no. Our volumes are too large for that. In other markets or areas, we do use shared models (where we perceive a need)."

Director of E-Commerce,
global multi-channel retailer

In the future, companies should take a second look at the long-term potential for shared-use because, as this report has shown, shared-use facilities can support peak management and demand fluctuations, enabling the flexibility that the market demands.

However, if the industry is to make shared-use solutions work, it will be incumbent on Third Party Logistics (3PL) providers, to offer customizable services within those centers. Traditionally, shared-use centers have offered one-size-fits-all approaches, which makes them less appealing in a sector where retailers want to control order cycle times and the delivery experience that are integral to the brand experience. As this changes, more retailers will see the long-term value of shared-use.

"One of the more recent examples of an industry shifting toward a shared-use approach can be seen in Life Sciences. Historically, large pharmaceutical manufacturers were focused on developing dedicated distribution centers across the country as the most effective way to meet customer demand. Dynamic market conditions, highlighted by tightening margins and global expansion, accelerated the need to identify a more flexible and cost-efficient supply chain solution. Shared-use facilities are proving to be an answer for Life Sciences, and many of the same benefits of shared-use make sense for online retailers grappling with heightened consumer expectations."

Fred Takavitz,
Exel Supply Chain

INVESTING IN FLEXIBLE SYSTEMS

Another form of growth comes from the continued rise of overall e-commerce volumes. As bricks and mortar retailers transform into truly multi-channel organizations, they increasingly seek to separate the inventory in the supply chain.

Retailers disclosed that the challenge with this process relates primarily to having the right systems in place to dynamically allocate stock between channels, rather than the physical structures themselves.

"Our biggest hurdle is system based – visibility, splitting inventory, managing purchase orders … that's more of a challenge than the physical distribution of goods."

Director of Supply Chain Strategy,
high-end fashion retailer

Hybrid stock systems may be expensive, but they can manage conflicts of interest between channels, reduce overall stock levels and reduce the impact of sudden demand peaks via one channel – so the benefits of the investment can quickly be realized through efficiency savings.

Overall, flexibility can be derived from implementing the right system, one that can support the fluidity that cross-channel services require, enable efficient sell-through of excess stock, and provide the visibility to make decisions quickly and intelligently.



CONCLUSION

The rapid growth in the online channel shows no sign of slowing in the near future, leaving many retailers faced with the challenge of how to keep pace. As a result, the combined effects of increasingly demanding consumers, volatile economic conditions, the fast pace of technological change and retailers' plans to grow their businesses make flexibility the watchword in e-commerce and multi-channel supply chains.

The core challenge retailers must solve is how to structure their supply chain. Whereas established multi-channel retailers can make changes to an established distribution model built to support stores, growing retailers without a vast network already in place are faced with a significant business decision of whether to develop an internal solution or outsource to a third-party logistics provider.

The outsource path provides retailers in any situation immediate gains in the speed, agility and scalability needed to keep pace with the rapid growth in online sales. Further, outsourcing partners can leverage best practices from other industries while providing scalable assets in the form of people and facilities. In this model, retailers can invest their time and resources in front-end systems and the overall customer experience.

In conclusion, retailers that make the right decisions at the supply chain level will deliver a consistent multi-channel brand experience that will drive customer loyalty and strengthen the retail brand by providing a service level that is attuned to the needs of the day.

Specifically, retailers with the right supply chain strategies stand to:

- Increase turnaround times by gaining efficiencies in the order processing cycle
- Gain operational efficiencies that help balance seasonal fluctuation
- Create a scalable infrastructure that supports rapid business growth

For more information on how to build flexibility into your supply chain, manage the demands of multiple channels or optimize your business for "peak" performance, contact Exel at consult.retail@exel.com.

ABOUT EXEL

Exel is the North American leader in contract logistics, providing customer-focused solutions to a wide range of industries including automotive, consumer, retail, engineering and manufacturing, life sciences and healthcare, technology, energy and chemicals. Exel's innovative supply chain solutions, skilled people and regional coverage bring together all aspects of contract logistics in addition to a wide range of integrated, value-added and specialist services. Exel is a wholly owned entity of Deutsche Post DHL, the world's leading logistics group.

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