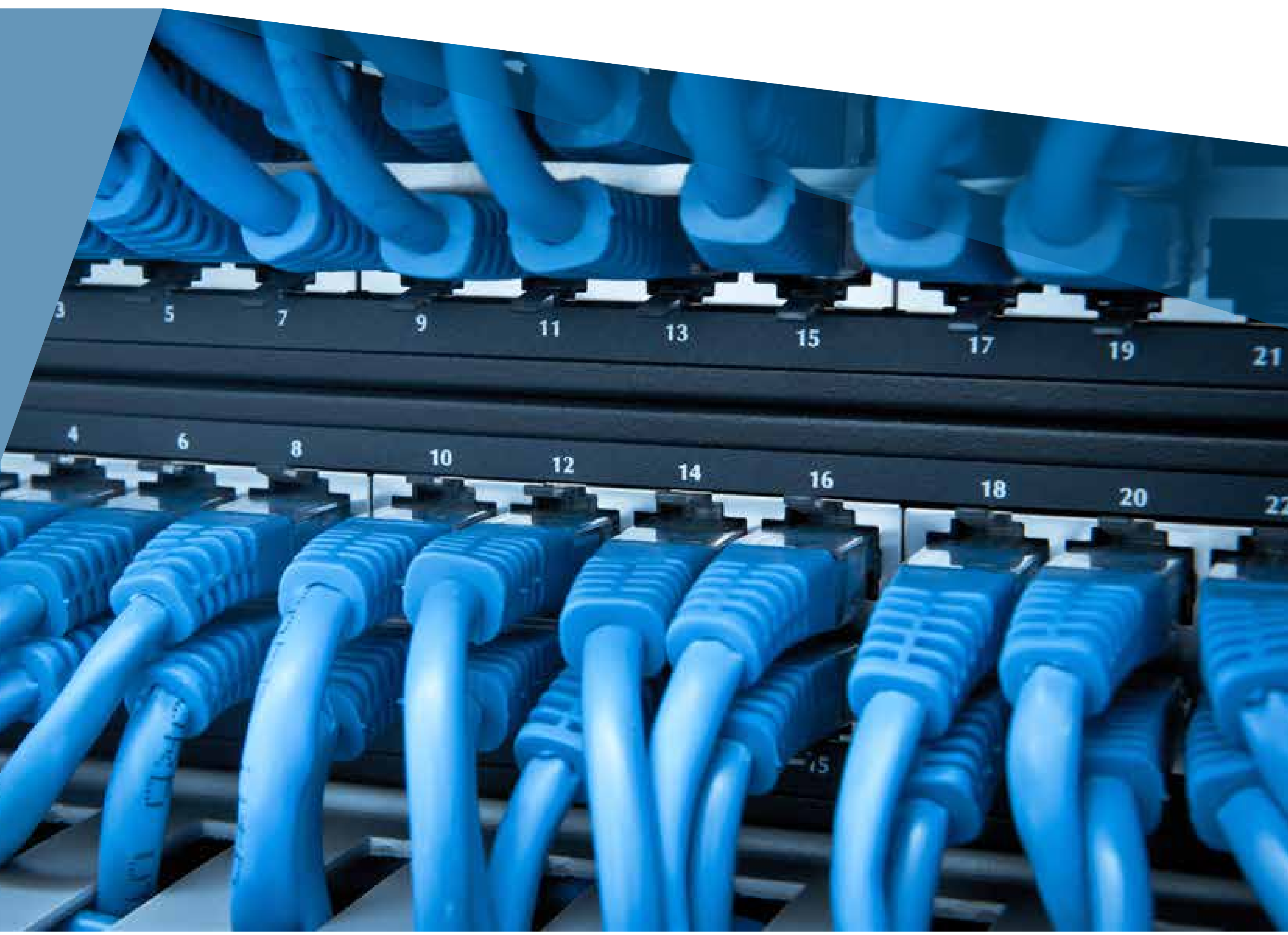
OLIVER WYMAN

OMNICHANNEL OPERATIONS: TWO STEPS TO SURVIVE AND WIN



INTRODUCTION

While e-commerce sales accounted for just eight percent of retail sales in the US in 2013 and 2014, cross-channel or "web-impacted" retail contribute to more than half of total sales today, a tipping point in omnichannel retail.[1]

At its core, omnichannel retail is about a gradual but important shift in consumer behavior. Now, consumers increasingly expect to discover, search, buy, pick-up, and return items seamlessly from various physical and digital access points.

Both established companies and start-ups have made significant investments in building omnichannel capabilities. For all players, omnichannel requires a dramatic and fundamental shift in mentality from cost-centric, largely hidden supply chains to front-and-center, customer-centric operations. As customers' expectations are evolving, retailers are testing a series of initiatives, including:

- More **access points**: online, mobile, stores, drives, lockers, pick-up and drop-off points, parcel shops
- More **delivery options**: after-hours, week-end delivery, time slots
- Shorter **lead times**: pick-up within 2 hours, same-day delivery
- **Flexible delivery points**: e.g. at train station for commuters, work place
- More in-store and "drive" **pick-up services**: reserve online (e.g. the Gap, Macy's), self-collect, pick-up in drive, endless aisles
- **Seamless experience** across access points and channels

This paper presents a new way of thinking about the operational implications of omnichannel retail and two steps retailers should take to survive and win in the new world:

1. **Consider four key plays** – focus on the four "plays"that will drive customer-centric operations
2. **Think and build agile** – design your organization and infrastructure to be flexible, innovative and one that embraces change rather than runs from it

1 Source: Forrester Research.

1. CONSIDER FOUR KEY PLAYS

While virtually every retail process is or will be impacted by omnichannel, we believe that there are four key strategic "plays" that are critical to support the transformation in the eyes of the consumer: dynamic network design and order fulfillment, existing asset utilization, last mile and delivery, integration with vendors.

CREATE DYNAMIC NETWORK DESIGN AND ORDER FULFILLMENT

The proliferation of new services will force retailers to develop dynamic network design capabilities, perhaps by leveraging or combining their existing footprint of distribution centers, platforms, and stores with third-party options to fulfill orders faster.

Beyond traditional DCs, retailers are increasingly relying on a more diverse set of models to accommodate different combinations of online versus in-store range, CAPEX requirements, pick-pack-ship volumes, access points, and lead time.

Exhibit 1: Dynamic network design and order fulfillment

APPROACH	RATIONALE	USE CASE
Store picking	• Offering a broad range of SKUs within two hours with minimal investment	• Click-and-collect • Ship-from-store
Dark store	• Higher picking productivity on a narrower range, for pick-up or delivery within two hours	• Click-and-collect • Same day home delivery
Fulfillment center	• High picking productivity on a broad range of SKUs for next day delivery • Can be dedicated to on-line or shared with brick-and-mortar	• Home delivery
Drop-shipping	• Expending range to long-tail of SKUs not sold in store through partnerships with vendors and wholesalers	• Home delivery • Endless aisles
Fulfill from vendor's DCs	• Very high volume SKUs allows to cut costs and inventory and accelerate delivery	• Home delivery

UTILIZE EXISTING ASSETS BETTER

Physical stores come with high capital and human costs, putting retailers at a disadvantage against their leaner online competitors. However, stores could also become retailers' most critical advantage in the race for offering fast and local services if they could be leveraged as platforms providing supply chain services, such as order fulfillment, pick-up and drop-off points, returns, ship-from-store, lockers, etc.

With current systems, processes, and layout, in-store picking productivity for grocery products rarely exceeds 40 to 60 items picked per hour – compared with 180 to 300 in a fulfillment center or dark store. Yet, we believe retailers will close part of the productivity gap through advanced inventory management and fulfilment systems and technologies, material handling tools, trainings and picking methodologies. This would provide them with a critical competitive advantage against online pure players.

BUILD LAST MILE AND DELIVERY CAPABILITIES

Delivery costs and services are among the most critical factors in choosing where to shop online. This has turned the last mile into one of the most powerful ways to differentiate in the market.

Exhibit 2: Last mile delivery

Home delivery	• UberRUSH • Deliv • Postmates	• Peapod • Google Express • Instacart
Pick-up & drop-off points (PUDO)	• Collect+ • amazon.co.uk	• Curbside
Lockers	• Amazon	• ByBox

Incumbent transportation carriers have for decades built hub-and-spoke infrastructure and fixed delivery waves to offer overnight or next-day delivery services for mid- to long-distance destinations. This model will increasingly become irrelevant for the last mile.

Online leaders such as Amazon and Google have invested more aggressively in last mile innovation than retailers and are shaping the way suppliers and transportation companies redesign their operations. Reflecting on how this impacts their own business model, retailers will have to consider three options to innovate in this space:

- Build their own proprietary delivery capabilities where they have volume and density
- Leverage radically new solutions offered by start-ups such as Deliv', Collect+, Instacard
- Push their traditional suppliers to innovate more and rethink delivery models

INTEGRATE WITH VENDORS

As part of Amazon's Vendor Flex program, P&G allowed Amazon to set up fulfillment operations within its own warehouses to reduce transportation costs and speed up delivery. While vendor managed inventory and other collaborative projects have existed for decades, this partnership is among the first in the online space. Target's public reaction to this partnership emphasized the importance and complexity of vendor-retailer partnerships in e-commerce operations.

Vendors are making considerable investments in direct-to-consumer capabilities and partnerships. Given the scale required to serve consumers, we believe that it will be in both vendors' and retailers' interest to better integrate and collaborate to achieve critical mass and serve clients. Areas of focus will include:

- End-to-end **distribution** approach, drop-shipping
- Integrated **planning** and forecasting, leveraging big data
- Real-time visibility on **inventory** and orders
- Real-time **replenishment**
- Differentiated **packaging** for online versus in-store

2. THINK AND BUILD AGILE

Traditionally, retailers have grown operations sequentially. Expansion plans are laid out and executed in a series of pre-planned steps over several months or even years. However, given rapidly evolving consumer tastes and technology, this approach comes at a cost. It is becoming more difficult to predict what the landscape will look like in two to three years, much less define and plan for what is essentially an unknowable end state.

Not only will consumer needs continue to evolve, but omnichannel will likely mean different things to consumers in various markets and sectors. Consumption patterns vary across geographies and sectors as it relates to access points and delivery services. For example, in grocery retail, click-and-collect accounts for over 90 percent of orders in France but has only started to take off in the US.

If the only constant is change, then building flexibility and evolution into the organization and infrastructure is paramount here. To be agile, retail operations will need to:

- Think of the end state as an evolving target and adopt a continuous improvement mindset
- Focus more on incremental steps and sprints rather than a sequential "marathon," where it is better to make progress frequently and tangibly in weeks and months, not years
- Consider working and live proof of concepts that impact the customer as the primary measure of progress
- Plan for experimentation and failure, fail quickly and cheaply
- Place a high value on simplicity, speed, and nimbleness
- Constantly reflect on progress and be faster, simpler, and more efficient

New and innovative approaches to systems and technology are also necessary to underpin the agile organization. Omnichannel brings a radically different set of challenges and requirements that are incompatible with most legacy systems and technologies, such as:

- Visibility and single view of product, inventory, customer, and order data across channels and stakeholders
- Real-time decision making
- Orchestration of multiple stakeholders: vendors, 3PLs, transportation companies, ecommerce platform, ERP, etc.
- Technology-enabled breakthrough in productivity and services: picking technologies and automation, in-store kiosks, etc.

How can retailers evolve their systems to enable customer-centric operations? @WalmartLabs is showing one possible way with 15 acquisitions conducted since 2010 in areas such as online community, search and discovery, predictive intelligence, and also cloud-based services for e-commerce and operations. Others are re-thinking the role of IT and service operations to bring them from behind the scenes to the front lines.

CONCLUDING REMARKS

The rapid growth of e-commerce is reshaping the retail ecosystem and the balance of power between consumer product brands, retailers, online players, wholesale distributors, and logistics groups. There is a fundamental shift in the way consumers shop, thereby increasing complexity for retailers. Retailers risk losing customers, cash-flow, and control of key elements of their value chain.

To survive and win in this context, we believe retailers need to shift their operations from cost-centric to customer-centric, focus on the right "plays", and become more agile and innovative to hit a constantly moving target.

“Omnichannel requires a dramatic and fundamental shift in mentality from cost-centric, largely hidden supply chains to front-and-center, customer centric operations”

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

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