The Long, Hard Road to an Omnichannel-Enabled Supply Chain

Kurt Salmon

The road to becoming truly omnichannel is long and hard. And retailers who have rounded the bend of their first tactical milestones are looking up only to see a massive strategic challenge looming ahead: profitability.

Under pressure to quickly build **customer engagement** models that support shopping and shipping choices, retailers are advancing new initiatives without fully understanding their costs. It might get them slightly further down the road for now, but long-term omnichannel success depends on calculating these new costs to serve and evaluating the operational, supply chain and IT investments—and tradeoffs—that will make these initiatives profitable. It requires transforming the retail enterprise.

The key to such **operational transformation** is a well-oiled supply chain, but the first steps are to enable new inventory, fulfillment and digital interaction capabilities. Few retailers are even close to completing this journey, but those who can differ-entiate between quicksand and a solid path will eventually be able to drive growth and profitability via the supply chain—not just save the sale.

OMNICHANNEL 101: SAVE THE SALE

When e-commerce was in its infancy, retailers responded quickly by building the capability to sell to consumers online. They added new e-commerce channels as separate lines of business—a legacy of the catalog fulfillment model—complete with separate SKUs, separate buyers, even entirely separate marketing plans and supply chains.

But, as a result, many retailers now have two distinct businesses under one roof—different organizations, cultures, processes, KPIs and vocabularies. One legacy of building these separate wheels of commerce so quickly has been misalignment, with one channel pulling against the other in a competition to capture and get credit for the sale. Customers have been taken on a wobbly ride.

The objective of omnichannel endeavors has since evolved beyond rescuing top-line sales to include brand strength, enterprise profitability and future growth. Fully embracing omnichannel and the business success it has hinted at for years means integrating the retail and online functions to provide a seamless customer engagement across multiple consumer touchpoints: one brand, one set of products and one customer experience across channels, all highly tailored to each individual consumer.

From **organizational structures** and operating models to information systems and decision-making processes, no aspect of the retail organization will be unaffected.

ADVANCED OMNICHANNEL: ENABLING A NEW GROWTH AND PROFITABILITY CATALYST

Supply chains, once simple support mechanisms, have become catalysts of future growth. Obversely, supply chains' growing importance also means their failings can cripple growth. Supply chain executives trying to optimize their supply chains do so under new scrutiny and within an enterprise that must keep rolling without disrupting the legacy systems, processes and strategies that are already live and critical to sustaining the business.

Sustainable, profitable, optimized omnichannel fulfillment starts with the engagement strategy—clarifying and refining the engagement model that aligns with the brand promise. It's why most retailers, though they have enabled ship-from-store, drop ship or other options, have yet to make those efforts either profitable or scalable: Retailers who ramped up fulfillment options quickly often took a ready-fire-aim approach of "What can I enable first with what I've got on hand or nearby?" rather than "What supply chain transformations make sense to my business and my customers?" They set out to align their wheels without ever defining where they were going.

A customer engagement strategy identifies who top customers are, how the retailer will engage with them across all touchpoints and what success looks like. From there, the best retailers will progress sequentially through a four-stage cycle in pursuit of omnichannel profitability. As they do, they'll find that the ability of their supply chain to serve as a business catalyst will grow with each stage. (See Exhibit 1.)

While department stores, boutique retailers and global brands may not pass through each level in the same way, and decision influencers will vary across cultures and geographies, the steps and goals in the four stages of the omnichannel supply chain maturity cycle remain essentially the same around the world.

THE OMNICHANNEL SUPPLY CHAIN PROFITABILITY CYCLE

1. **Enable Engagement:** The first question about enabling omnichannel fulfillment efforts should be neither "how" nor "when," but "whether." When decisions are grounded in their engagement strategies, retailers can better determine which channels need to be developed, both near term and longer term. Even with this clear vision in place, enabling these channels is an intricate and comprehensive change management effort to overhaul and align inventory management, store fulfillment processes, POS technology, and organization and supply chain visibility. And this is only the beginning. (See Exhibit 2.)
2. **Balance and Refine:** Get inventory in the right place and refine planning and measurement methods to take the inventory management from "I have the item and can get it where it needs to be" to "I have the item where it needs to be." Staff engagement and culture change will play major roles here, as old habits must be unlearned as retailers focus not on whether a channel logged a sale, but on whether a consumer, no matter where or how, made a purchase. E-commerce and store inventories

Exhibit 1: The supply chain's role as a business catalyst evolves with each stage.

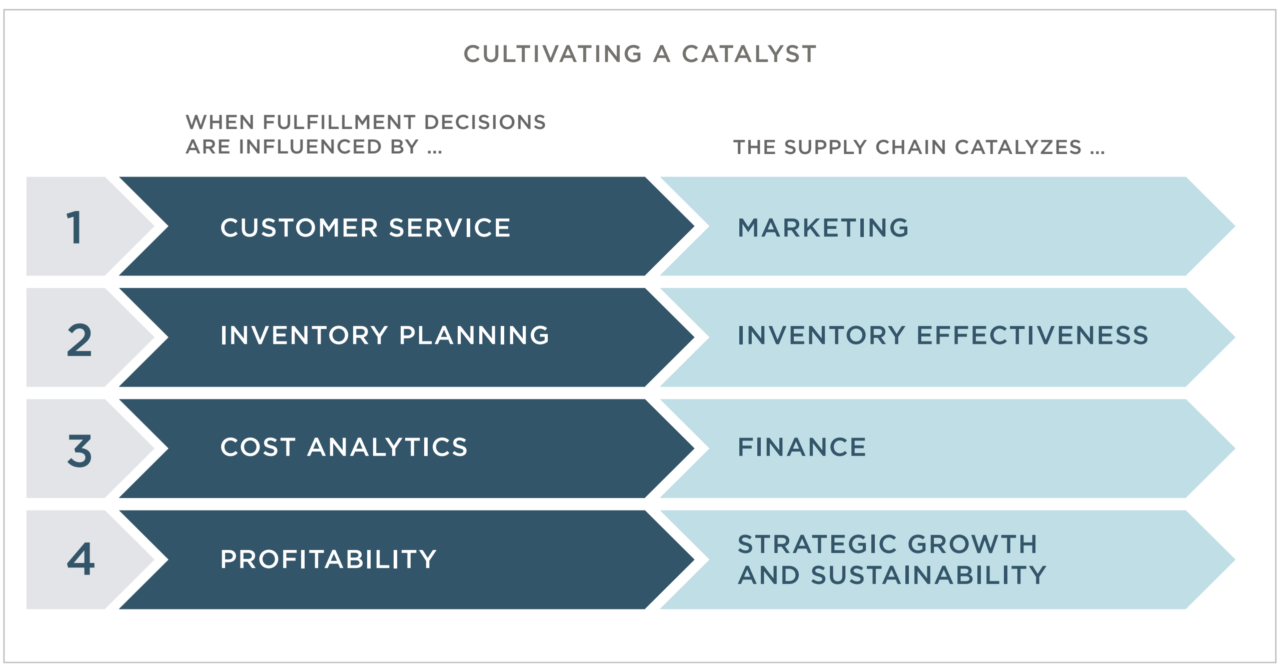

Exhibit 2: Enabling new methods of engagement and fulfillment is only the first step in the cross-enterprise effort to become truly omnichannel.

THE FOUR STEPS TO OMNICHANNEL SUPPLY CHAIN PROFITABILITY

Step	VALUE	CRITICAL CAPABILITY	SUPPORTING SYSTEMS
1 Enable Engagement What is required to enable stores to become an omni-channel node?	• Save the sale • Reduce markdowns • Increase or protect market share	• Customer engagement strategy • Inventory visibility • Store fulfillment	• Order management system • POS system
2 Balance and Refine Where and how can inventory be positioned and leveraged to improve the omnichannel experience?	• Improve fill rates and revenue • Improve inventory positioning • Minimize split shipments • Improve service levels	• Visibility to demand across all channels • Seamless inventory buying and planning across multiple channels • Improved inventory planning and management • Improved inventory positioning	• Advanced PO management system • Inventory management tools • POS data visibility by channel, SKU and demand location
3 Manage the Cost to Serve How are fulfillment nodes used to minimize costs while still hitting service goals?	• Reduce fulfillment costs • Improve service levels	• Decision rules informed by engagement strategy • Cost-to-serve metrics, visibility and decision-support tools • Accurate, dynamic view of master cost data • Advanced OMS functionality and analytics	• OMS analytics and optimization • Fulfillment cost analytics by channel and node • Improved carrier options/relationships • OMS optimization
4 Enable Profitability Where and how are customers engaged over their lifecycles to drive toward a profitable experience allowing for service, node and channel tradeoffs?	• View to the long-term customer margin impact • Improve profitability by channel and node for each customer segment	• Make tradeoffs between profitability and engagement strategy • Automate rule configuration • 360-degree view of the customer • OMS optimization and analytics	• Advanced OMS analytics and optimization accounting for margin • Fulfillment margin analytics by customer segmentation, channel and other processing attributes

must be integrated into “one retailer,” and flow paths must be enabled to connect distribution centers that may not have talked to one another before. Success at this stage is measured by inventory integration and optimization.

3. **Manage the Cost to Serve:** In stage three, retailers who have enabled omnichannel fulfillment and inventory integration evaluate how much their processes are costing them, from store labor to expedited shipping, and they examine the tradeoffs required to improve service to their top customers. Such evaluation requires a master dataset that incorporates inventory, shipping, direct order management, social listening, labor cost and other datasets, as well as complex simulations to measure tradeoffs. These datasets and simulations must be run regularly to allow a retailer to adapt quickly to shifting variables such as seasons, new technologies, weather or labor events, and evolving consumer expectations. Cost analytics drive fulfillment decisions at this stage, and success means navigating tough choices and being able to interpret the master dataset to make those decisions in a profitable, customer-centric way. Where should inventory be positioned, and where should it not? How can excess stock be most efficiently leveraged to avoid markdowns? What shipping method will be the least expensive yet still provide delivery on the desired in-home date?

4. **Enable Profitability:** Up to this point, understanding the cost to serve has been the most complex stage in the cycle. But the most crucial stage of generating a new retail paradigm is the fourth, when retailers leverage cost-to-serve knowledge to execute tough tradeoffs in pursuit of sustainable, scalable, customer-centric profitability. To inform these decisions and how they are applied to various customer bases, successful retailers will evaluate the profitability of each customer—rather than each transaction—and will not necessarily put every customer first every time. They will reject the peer pressure to compete on other businesses’ terms in favor of acting in their own and their top customers’ well-informed best interests. They will strike a careful balance between consumer and business demand, knowing where they stand compared to others and how to move forward from their current position.

Omnichannel supply chain optimization is a cycle, not a race. Omnichannel profitability will quickly become a moving target, and the entire model and landscape will continue to shift as the inputs change and evolve with the development and definition of new nodes, shipping methods and customer engagement strategies. As retailers achieve profitability and are able to successfully scale their channels within the new retail paradigm, the next step after the last one will always be a return to the first. The best retailers will revisit and refine their customer engagement strategies based on learnings from each stage, and they will do so over and over. ❖

A LOOK AT RETAILERS IN MOTION

Retailers around the globe are at varying points in omnichannel supply chain maturity. While some may have progressed to enabling new fulfillment options, they often started without aligning those efforts to a customer engagement strategy, and they will likely have to back up before they can move forward. Others, who may have joined the journey later on, could advance faster, having stepped back to plan first and forsaken early saved sales for longer-term relationships with engaged customers.

Enable Engagement: Several retailers exemplify the tradeoffs of fast vs. thorough ship-from-store implementation. A $1.6 billion specialty retailer enabled ship-from-store at hundreds of stores at once. While the technology implementation went well and markdowns were reduced, the rollout was bumpy: Sales staff were overburdened by fulfillment because rules and configurations didn't do enough to protect business processes. Some stores opened their doors to find hundreds of orders waiting in their queues. Similarly, a $4 billion department store that didn't outline clear process ownership or provide thorough training ended up paying consultants to ship boxes to fill demand.

By contrast, a $2.2 billion multibrand specialty retailer phased in ship-from-store capabilities, starting at a few select locations. With multiple complex and customized systems to integrate, and significant training and hardware requirements, the effort required considerable cross-department collaboration. But because it phased its approach, it could identify and address technical and training issues along the way. This allowed advanced optimization rule testing and implementation to move quickly once the system was fully live, when the retailer reduced split shipments by 6% by rerouting orders previously tagged for DC distribution to stores that could fulfill the complete order. It anticipates a pure profit of $50 million in the first full year by selling distressed store inventory at full price online.

Balance and Refine: According to Kurt Salmon's 2014 and 2015 Peak-Season Omnichannel Fulfillment Studies, many top retailers are advancing along stage two, but aren't yet through it. Over the 2013 holiday, 35% of multi-item orders originated from two or more shipping points, and 42% came in multiple parcels from a single distribution center, indicating that while inventory was available, it wasn't in, or wasn't delivered from, the most efficient location.

With e-commerce growth projections in the 25% to 35% range, a $15 billion department store exemplifying some of these challenges had outgrown its expansion tactics. Adding yet another distribution center wasn't going to be enough, especially given added complexities of 15% to 20% yearly SKU growth, increased peak-season promotional activity, and a desire to improve customer service and asset utilization.

Kurt Salmon helped the retailer get multiple departments together to design a comprehensive solution. The result was a cost model that captures inventory, fulfillment and transportation costs, with dynamic service level constraints that influence allocation and fulfillment strategies.

Using that new model, the retailer found new ways to save 20% in transportation costs, improve customer service levels by 15% and make peak-season shipping more efficient.

Manage Cost to Serve: A U.S. retailer's $1 billion e-commerce channel was losing money, but the retailer couldn't identify which categories were performing well and which contributed to losses.

The e-commerce channel was fully functional, but merchants were onboarding over 4,000 SKUs per month with no understanding of their profitability.

The retailer sought to optimize its inventory placement to reduce transportation costs and to cost-effectively balance owned vs. drop-shipped fulfillment. By implementing a custom-built analytical tool, the retailer was able to calculate and manage its cost to serve. The tool calculated net profitability for each existing SKU based on inputs including transportation and fulfillment costs, shipping node, owned vs. drop shipped, inventory carrying costs, and more. It also layered in forecasting functionality to predict new SKU revenues and costs.

The retailer immediately found low-performing SKUs and categories. It also identified and implemented changes that saved $6 million in transportation costs within three months, and it found another $15 million in future savings that could be achieved with additional investment.

Enable Profitability: In 2013, Amazon spent $6.64 billion on shipping, but received only $3.1 billion in shipping payments, according to the *Wall Street Journal*. And even the elephant of free shipping and one-day (or less) delivery times recognizes that not every customer can have it all for free, every time. The cost of Amazon Prime rose in 2014 to $99 from $79, where it had stood for nine years, and Amazon Prime and Prime Pantry have evolved in part to consolidate shipments. Some products have been recategorized as “add-on items” and ship only if they are included as part of a larger order. The 2014 introduction of Prime Pantry created a shipping option that would send 45 pounds of food for a flat rate of $5.99—which even Prime members must pay—but Amazon no longer ships individual Pantry items that formerly qualified for free two-day Prime shipping.

At the same time, Amazon says it has partnered with vendors to triple the number of items that qualify for free shipping after a $35 minimum order size. In making these tradeoffs, Amazon realigned its offers to its most valued customers in a way that still meets those customers’ needs.

Kurt Salmon
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We call it delivering "success for what's next." The results are transformative.

AUTHORS

Together **Mike Gregory**, **John Seidl**, **Jon Mays** and **Brooks Kitchel** have more than 80 years of experience helping clients transform their operations into competitive advantage. Their clients include some of the world's largest retailers, grocers and global brands, as well as specialized consumer companies.

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