Building a Specialty Apparel Fulfillment Network with Room for Growth

Remember the days when determining a network strategy was as simple as examining inbound and outbound volumes and factoring in transportation costs?

Unfortunately for retailers, those days are long gone. With dozens of new variables entering the picture, significant growth in e-commerce sales and a growing demand for omnichannel fulfillment, defining a network strategy can now seem overwhelming.

But as competition increases, developing an optimized network is more important than ever before.

The first step to developing a network strategy that will meet present and future needs is to understand the key variables that drive both the need for and direction of a network change. Next, explore the range of options that make sense in each particular situation. Finally, define the existing network and ideal future-state fulfillment strategy.

The ultimate goal is to change the network to proactively meet future strategic needs rather than scrambling to change the network after the fact.

Understand the Drivers: Growth and Strategic Triggers

Growth triggers

Growth can come organically, via increasing sales, or inorganically, via company or brand acquisition.

When exploring organic growth, the primary trigger for change is significant growth in a single channel, region or brand in a short period of time. The operative word here is "single." For example, e-commerce sales may have grown from 5% to 10% of total business, while overall sales have increased only slightly or stayed flat. Each of these scenarios will require an increase in overall network capacity. Growth will also lead to changes in transportation costs that may be offset by a change in the network.

Likewise, when exploring inorganic growth, the primary trigger is the need to increase or decouple infrastructure due to an acquisition. After an acquisition, the stress on a network is not always growth related. It may be that there are suddenly too many distribution centers and there is a need to consolidate to reduce excess capacity, save on overhead or reduce transportation costs. Similarly, excess network capacity may occur when a brand or business is rapidly shrinking.

These growth triggers have long been standard reasons for a new network design. However, strategic triggers have now become an equally powerful driver for exploring an optimized distribution network.

Strategic triggers

For many retailers, the ideal future state is an omnichannel model that allows customers to seamlessly shop across stores, mobile devices and e-commerce sites. The requirements for omnichannel retailing vary, but all require immense distribution change. When considering that each channel may require different types of services and different service-level expectations, it becomes clear that creating a seamless network is no easy feat.

Several other strategic factors can drive the need for a new network strategy, including increasing markdowns in stores (leading to more hold and flow), increasing private-label sales and a change in sourcing strategy. As when examining growth triggers, the ultimate goal is to change the network to proactively meet future strategic needs rather than scrambling to change the network after the fact. After determining that a new network strategy is required, the next step is to explore potential options for the future-state network.

Understand the Options

There are essentially four U.S. network strategies in use by specialty apparel retailers today: centralized single-channel distribution, centralized omnichannel distribution, regional distribution and hybrid distribution.

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Centralized Single-Channel Distribution

In this approach, companies distribute product to specific channels from dedicated and centralized distribution centers. For example, Ann Inc. fulfills all of their retail stores from one distribution center in Louisville, Kentucky. For companies that have two distribution centers (one for retail and one for e-commerce), such as Express, it's common to transfer stock from one DC to another to rebalance inventory.

This model is increasingly popular with companies venturing into the e-commerce space for the first time or for companies with specific pack- or service-level requirements for each channel. Single-channel distribution centers tend to be located in close proximity to outbound centroids (mathematical concept used for finding a geographic center based on populations or manufacturing hubs) for retailers and inbound centroids for wholesalers, as retailers typically pay for outbound shipping costs.

This method has historically worked well for small- to medium-sized retailers and larger wholesalers. It is particularly efficient when the majority of retail flow is "flow through" or requires very little replenishment. It also supports steep peaks in demand due to better inventory coverage, and it benefits retailers who source from one region.

Centralized Omnichannel Distribution

In this approach, companies use a centralized building to fulfill multiple channels (retail, wholesale, e-commerce). For example, Guess has a facility based in Louisville, Kentucky, that fulfills their retail and e-commerce channels. This strategy is also popular with retailers like Forever 21, Pacific Sunwear and Quiksilver because it simplifies inventory balance between channels and allows for "click and collect" (ship-to-store) models where consumers order online and pick up in the store.

However, as network size grows, there is often a need to add a West Coast (or dedicated e-commerce) distribution center to reduce lead times. Centralized locations also add to delivery times and make next-day delivery more expensive when shipping from national centroids, especially for e-commerce, which has higher service-level requirements. Once omnichannel distribution is a reality, a number of additional possibilities are available for individual distribution centers within the network.

Regional Distribution

In this model, distribution centers are placed regionally, based upon the geographic distribution of a company's stores. This is the traditional retail model and is currently the strategy for most national department stores. Aéropostale, which has separate distribution centers for the West Coast, East Coast and Canada, is a good example in the specialty space.

This network's main advantage is that it allows for optimization of both inbound and outbound freight. This leads to very efficient freight networks and significantly decreased transportation costs.

This regional approach is applicable not only for retail fulfillment—many national chains that have regional brick-and-mortar distribution centers also have separate regional centers for direct-to-consumer distribution.

Hybrid Distribution

This network strategy combines elements from multiple distribution strategies.

For example, a company may have centralized omnichannel distribution with a regional distribution center. This method is becoming more common as companies add a West Coast facility to their network to deal with increased demand.

For example, American Eagle has one distribution center in Warrendale, Pennsylvania, which supports the East Coast, and one center in Ottawa, Kansas, which supports the West Coast and all direct-to-consumer.

Urban Outfitters is currently moving to this approach by opening a distribution center in Reno, Nevada, to handle their West Coast and e-commerce demands. Many companies are also turning toward ship-from-store models, which allow retail stores to act as miniature fulfillment centers. This allows for a much wider geographic spread; in essence, companies moving toward this model are using their stores as regional fulfillment hubs.

Develop the Strategy

After defining key business drivers and potential solutions, the next step is developing the new network strategy.

The easiest way to approach the development process is to split the variables involved into inbound and outbound factors. For example, if the primary driver for network change is a shift in sourcing volumes from one coast to another, then the ultimate goal is to create sufficient change in the inbound network. On the other hand, if the primary driver for change is an increase in e-commerce shipments, then the focus should be on changing the outbound network.

The first step in developing the strategy is to examine current and projected inbound volumes, including examining inbound volumes by channel, port (i.e., West Coast vs. East Coast volume), international and domestic sourcing, and consolidation points. These inbound volumes are all impacted by projected direct-ship volumes, which can drastically alter projected networks. Finally, these projections are stress tested for risks such as natural disasters, port disruptions and union activities.

Next, examine the outbound variables. As previously discussed, regional store growth and increasing e-commerce sales are often the main reasons for a network change. These factors are equally important when examining an outbound network's future state. Factor in historical and projected volumes by channel (including new channels such as e-commerce or wholesale), region, country and product category.

Of course, defining future business and service requirements is also essential to developing a successful network strategy. Will there be major product launches or online sales increases to contend with at certain times of the year? What is the peak to average outbound volume during the course of the year? Do customers expect or need next-day or even same-day deliveries? Can the network be leveraged to redefine brand strategy (for example, moving to a fast-fashion model)? Are product attributes changing? Is ship-from-store a viable option? Answering all of these questions is just as important for a successful network as the volume calculations outlined above, and the answers can mean the difference between a serviceable distribution network and a true source of competitive advantage.

Simply defining the relevant variables is a time-consuming and difficult process, and creating a robust and accurate model for examining each scenario can be overwhelming. But once a network's capacity has been met or exceeded, pushing these issues aside is often no longer an option. Taking a strategic, long-term view of network strategy and development will help ensure the resulting network meets today's needs while leaving room for future growth. ❖

CASE STUDY

A $2B specialty sportswear retailer seeking to validate its plans for expanding its logistics network to the U.S. West Coast and Canada

ISSUE: The retailer experienced rapid growth and required additional distribution capacity to effectively support store operations and provide timely and accurate product movement to stores.

SOLUTION: After examining the cross-functional supply chain activities required to coordinate and operate a West Coast and Canada distribution center—including logistics, allocation, merchandising and IT requirements—the retailer implemented a network solution that balanced inbound sourcing destination points with outbound customers.

RESULT: Increased speed-to-market and reduced transportation expenses, which resulted in a $9.5 million annual reduction in cost of goods sold (COGS).

AUTHORS

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