The Customer-Centric Supply Chain

Prospective View: October 2013

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Overview

Change Drivers in the Retail Supply Chain

The retail business model has two "sides", one being the supply chain-facing "buying side", and the other the customer-facing "selling side". Recently, there has been a tremendous amount of energy put into the selling side in response to new consumer shopping behaviors enabled by consumer technologies (the web, "smart" mobile devices, and social media). Up until now, retailers managed to avoid major disruptions to the buying side of the business to support these new digitally enabled shopping behaviors.

The dramatic shift in consumer shopping behaviors has forced retailers to scramble to show one brand face to the customer across all the selling channels as well as enable some cross channel fulfillment capabilities. But how they have actually delivered on those brand and fulfillment processes leaves a lot to be desired - primarily because retailers have tried very hard to keep the response to consumer behavioral shifts from impacting their supply chains. The reluctance to change is important: retailers have optimized their supply chains to deliver the best cost of goods at the lowest cost possible – based on the assumption that the store is where virtually all consumer shopping takes place.

Today, retailers accept that multi-channel shoppers are here to stay. And retailers increasingly recognize that shoppers who cross channels are much more than "nice to have" - they are rapidly becoming *must-have* customers, in large part because they are so much more profitable than single-channel customers (Figure 1).

Figure 1: No Doubt
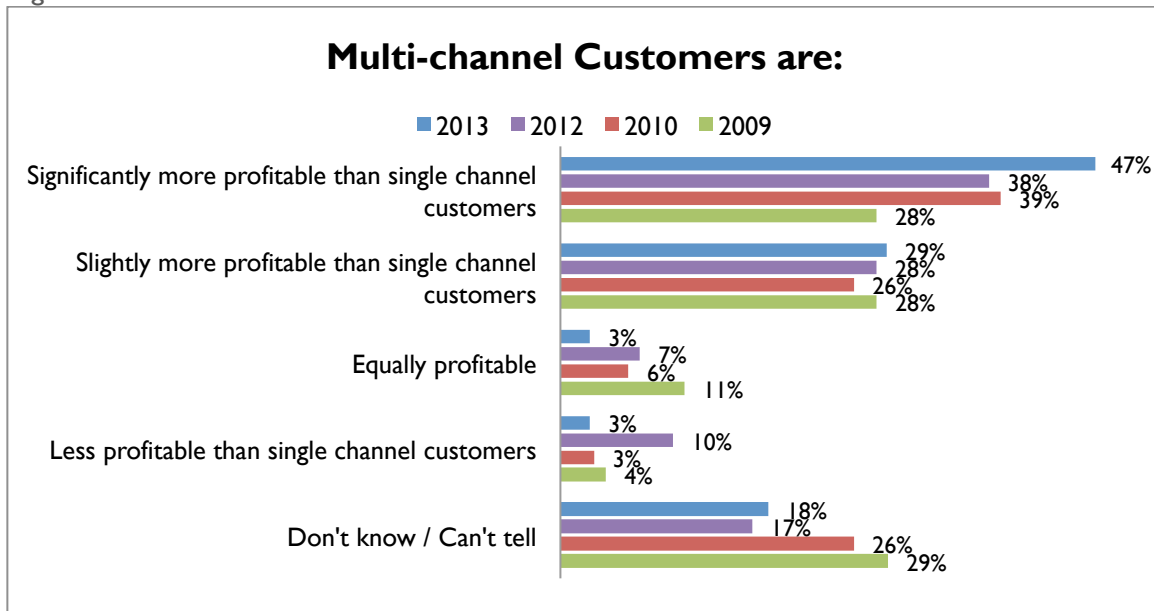
Source: RSR Research, June 2013

The question is, are multi-channel shoppers more profitable because they are simply the kinds of shoppers that are already highly engaged? In other words, were these already the retailer's most profitable customers? It appears that the answer to that is "no". Retailers who have specifically targeted single-channel, relatively unprofitable or unengaged shoppers, and enticed them to

cross channels, have found that the more channels they can entice a shopper to add, the more profitable and engaged that shopper becomes.

That's great news on the selling side of the business - a clear lever for retailers' marketing teams to move to improve top line results. The problem is in meeting the promises that must be made - and kept - to meet the increasingly higher expectations that cross-channel shoppers have, and ***to do it profitably***.

The Old Model Is Obsolete

Retailers are making cross-channel promises to customers - their most profitable customers - that are increasingly difficult to keep. Traditional retail supply chains, no matter the retail vertical or supply model, were built to support one channel, and one channel only: stores. Such a supply chain operates with the following design assumptions:

Constrained Assortments Over Variety

Traditional retail supply chains were built to acquire product at the best possible cost and move it as cheaply as possible. The best price was achieved by buying at greater volume and rationalizing the assortment to include only the best moving items, to avoid having too much of the wrong or slow moving inventory. The net effect was a lower price for consumers, but also less choice.

Now digitally enabled consumers are revolting against less choice. Retailers need to find the formula for having more localized and relevant assortments at their stores, and greater selection anytime and anywhere.

Efficiency Over Flexibility

Not so long ago, there was only one road to the consumer, and it led through the store. Supply chain design in this environment became about optimizing well-worn paths from supplier to store.

But as consumers increasingly cross channels on their way to a purchase, retailers are forced to reconsider how they position inventory in order to meet demand. The e-channel is not just a virtual store. It is a window into all stores and all inventory available across the chain, and in the case of dropship vendor relationships, even beyond the chain. The new supply chain must be able to ship "eaches" to a store or directly to a customer. And in the new supply chain, the store is not only a destination for inventory, it's also a source.

Push Over Hybrid

Most retail supply chains were never designed to accommodate product movement beyond the one-way delivery to the store, where it would likely only ever leave the store in a customer's shopping bag. Accommodating all of the new possible fulfillment options (order online/fulfill in-store, order in-store/fulfill direct, order in one store/fulfill in another, etc.) requires not only increasing the flexibility of supply chain, but also giving up a little on efficiency in order to sell a lot more than ever before.

One Path-to-Purchase

Once upon a time, "brand" was an investment in getting a consumer to choose a store. When the shopper reached the store, the retailer had every opportunity to turn that shopper into a buyer. The assumption became that the customer's buying process (need, research, selection, and transaction) would all happen within the four walls of the store.

For supply chain, that meant that the store's assortment and in-stock levels were the most important things to maintain. When the efficient use of capital wasn't the issue that it has become, it was easy to be overstocked, because out of stocks were a much greater risk.

But now availability is a commodity. And *where* inventory is physically stocked in a flexible supply chain is less important. **In stores, the emphasis will shift from product availability and price to service**, simply because all of the research activities related to selection, availability, and price will have happened long before the customer ever sets foot in the store.

Transaction = Demand

In a world where the store is the only destination, retailers built their demand assumptions around the idea that the store transaction is a fair signal of demand. That has changed. The store is no longer the only buying destination that can capture demand, and even more importantly, consumers' activities in the digital space have the potential to signal demand intent long before a customer ever pushed the "buy" button.

For supply chain and for merchandising, this means two significant differences in the way retailers have historically operated: first, demand planning needs to look much earlier into the buying process to understand customer buying intentions. Second, retailers on long planning cycles will not be able to anticipate where these pre-transactional demand signals lead. Supply chain, rather than merchandise planning, will have to take up more of the burden of meeting demand by being more responsive to current conditions and emerging demand.

Space is a Constraint

Finally, the assumption that a retailer can only sell what the store can stock is past. SKU rationalization takes on far more strategic implications for the business, because products must be considered across lifecycle, customer impact, and *channel* impact. With the opportunity to sell anything from anywhere, endless aisle and dropship concepts threaten to change the game.

A Digital-Driven Future

The old assumptions driving supply chain design and investment were appropriate to be able to achieve the lowest possible cost of goods and the most efficient distribution to stores, but a new model is emerging, not driven by enterprise technology or supply chain innovations but by customers themselves. In the omni-channel retailing world, almost every single store-driven assumption about supply chain is being challenged - and getting replaced by a digital-driven future (Figure 2):

Figure 2: Old vs. New Supply Chain Requirements

Old Supply Chain Requirements	New Supply Chain Requirements
Assortment rationalization	**Assortment variety**
Efficiency	**Flexibility**
Push to Stores	**Store as Destination and Inventory Source**
Store as Self-Contained Path to Purchase	**Anywhere / Anytime Shopping & Fulfillment**
Transaction = Demand	**Digital Demand Signals, Pre-Demand**
Space as a Constraint	**Endless Aisle**

Source: RSR Research, October 2013

Anytime/Anywhere Shopping Behavior

When shoppers can buy anywhere, and retailers can deliver from anywhere, it changes the demand equation significantly. For fashion retailers on the front lines of this phenomenon, new terms like "depth of demand" are emerging, where online exposure to inventory availability across the chain is forcing them to rethink assumptions about where to stock, when to mark down, and even which customers will buy which products.

Store as Both Destination and Source of Inventory

Part of being able to capitalize on anytime/anywhere shopping behavior will depend on retailers' ability to use stores as more than just a destination. This is particularly important when competing with online-only retailers that are aggressively pursuing same-day ship as a precursor to same-day delivery. Store-based retailers' greatest opportunity to combat online speed is to leverage their store network - for national retailers, a pre-existing installed base of what may well become part-time mini-DC's.

Digital Demand Signals

The transaction is not the be-all, end-all of customer intent. And while retailers may not have yet cracked the code on interpreting the role that online searches, ratings and reviews, and page visits may mean to demand forecasts, the retailer who figures it out first will have a significant advantage over peers - especially if they can respond to those signals proactively to best position inventory to meet that incipient demand.

Endless Aisle

When space is not a constraint, retailers will have to rethink the purpose of in-store assortment - will they stock only impulse items and promise speedy delivery of the rest? Will they encourage online purchase or reservation of inventory, so that it can be ready in the store when the shopper arrives? Endless aisle may well imply endless variations of inventory models, none of which depend on allocation against "model stores."

Anytime/Anywhere Fulfillment Expectations

Consumers not only want to buy anytime, anywhere, they want to receive their products on their terms and with more visibility than many retailers have into their own operations. For supply

chain, this means a strong direct-to-consumer capability, including keeping track of the customer experience when it comes delivered in a box, not in a store.

Challenges and Opportunities

The Time to Change

As recently as 2007, studies showed that retailers were unconcerned about the impact of the new shopping anytime/anywhere behaviors of their customers– for most, online was still such a small part of their business that they didn't feel they needed to make supply chain-related adjustments in order to cope with online sales. Those companies that excelled at operational excellence in the supply chain became the industry's channel masters, able to search the globe for the lowest cost product and distribute it to stores with few intermediate (and potentially cost-creating) steps along the way.

But the time to change has arrived. Supply chain evolution is a relatively slow process, especially when compared to the rapid rate of change in the selling environment itself. But both over-performing retailers ("Winners") and their lesser-performing competition are feeling the pressure - directly from consumers - to address the supply chain (Figure 3).

Figure 3: Feeling The Pressure
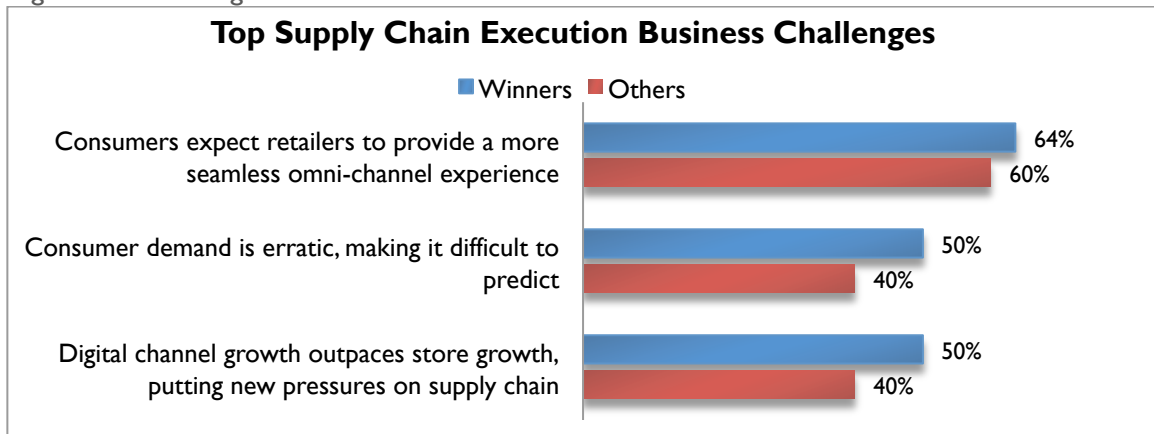
Source: RSR Research, July 2012

A buy anywhere/get anywhere digitally-enabled selling model has emerged, particularly since the wide consumer acceptance of "smart mobile" technologies, and that forces a re-think of the entire retail supply chain. For most retailers, that means redefining the stores' role in the supply chain, from being purely on the receiving end to being an active participant as both a destination and a source for inventory. But it won't be easy; past optimization favoring the store as the principle selling channel has the downside of having created a highly verticalized and rigid supply chain design. No one is more aware of this than Retail Winners – the very retailers whose push-oriented supply chains helped them to gain a seemingly insurmountable competitive edge over the competition.

But it also stands to be the biggest opportunity of the next several years. Retailers must support new customer-centric fulfillment strategies such as buy online/return in-store, buy online/ship to consumer, and buy online/fulfill in-store, but they also must protect profitability. In this age when retail prices are transparent and inventory availability is visible to consumers, retailers' ability to

continue to deliver best cost of goods, *and* to fulfill customer anytime/anywhere orders efficiently is the key to future success. And they have to get faster at it – new competitors like Amazon have made the speed of fulfillment a competitive threat.

The New Model Emerges

To keep their promises to omni-channel customers and to meet their sales and profitability objectives, successful retailers are rethinking their supply chain designs to have the following attributes:

Globalization, Localization… and Omni-Channel

Global sourcing is and will continue to be an imperative of retailers everywhere. At the same time, the best retailers know that it is no longer about what they want to sell to consumers, but what consumers want to buy. **Localization of store assortments** is a key success strategy. Consumers want relevancy, and they increasingly are unwilling to accept limited assortments from retailers.

The answer to the conflict created by the dual objectives of global sourcing and localized assortments is to offer **true omni-channel selling and fulfillment**. Depending on the customer order fulfillment strategy that each retailer develops as part of the brand experience, the role of the store as a source as well as a destination for inventory is a major consideration. And those fulfillment strategies must include having the ability to find the lowest cost inventory needed to fulfill a customer's order, and the best and fastest way to deliver the goods, when and where the customer wants it. **Small Package and Reverse Logistics** will become important - for store-to-store shipments, direct-to-consumer deliveries, and customer returns. But retailers cannot afford bloated inventories either. To that end, there will be **new rules for store clustering** in an omni-channel design, and **space optimization** will become increasingly important.

360° of Inventory "Visibility"

Visibility into all inventory - on-hand, on-order, and in-transit - is a prerequisite to enabling a *buy anywhere/get anywhere* selling model. Retailers should be able to enable an "endless aisle" assortment to consumers by harmonizing the digital and physical selling environments, creating one brand experience that traverses all the selling channels.

And retailers who engage in **dropship** as part of their fulfillment options enable visibility beyond their theoretical "four walls" – into suppliers' inventories.

Getting Forecasting And Replenishment Right

Replenishment-oriented retailers have a big opportunity to improve flow-through with the help of technology. That is enabled by improved forecasts, real-time and accurate inventory visibility across the enterprise, and (to a slightly lesser extent) inventory optimization across all channels. Winning retailers of short lifecycle products also see an opportunity for better forecasting. For all retailers offering a seamless brand experience across all selling channels, **a single view of the forecast** that is aligned to demand is critical.

Key Questions to Answer

For all retailers, addressing the buying side of the business in an omni-channel age is a new endeavor - an unpaved road. There is no right or wrong approach (other than perhaps ignoring the issue completely), and the ultimate destination will depend on the retailer's size, vertical, and brand value proposition. But there are several questions that, one way or another, will need to be addressed:

A. How does your company consume new "non-transactional" demand signals coming from the digital selling environment?
   a. To forecast demand for the entire selling environment?
   b. To measure the effectiveness of omni-channel order and fulfillment strategies?

B. Are your assortments and inventory optimized at the local level?

C. Do you/have you:
   a. Share granular demand with suppliers?
   b. Integrated supply and demand planning?
   c. Implemented product lifecycle management controls?

D. Have you determined the *fulfillment role of the store?*

E. Are your Supply Chain, Merchandising, and Marketing execs working (well) together to *align the sell-side and buy-side* of the business, to design one Brand experience across all channels, and effectively execute that strategy?

F. What are the new rules for assigning both the costs and the revenue of a Cross-channel transaction?

G. What are the right technology choices to enable "360° visibility" of:
   a. Inventory?
   b. Product?
   c. Customer?
   d. How far does your "endless aisle" extend? To other stores? DCs? Sources?

H. What has to be accomplished to enable more accurate and timely inventory management for the entire enterprise?
   a. "Closing the loops" in selling and buying systems?
   b. Finding more efficient ways to take account of physical counts and locations?

Appendix A: Relevant RSR Research

Methodology

RSR uses its own model, called the BOOT℠, to analyze retail industry issues. We use this model with our survey instruments. The model is useful to help contemplate business and process issues and opportunities as perceived by a broad swath of retailers. We can find commonalities and differences, and also understand the impact of enabling technologies.

In our surveys, we continue to find differences in the thought processes, actions, and decisions made by retailers who outperform their competitors and the industry at large. This remains true even in our uncertain economic climate. The BOOT℠ model helps us better understand the behavioral and technological differences that drive sustainable sales improvements and successful execution of brand vision.

RSR Research Referenced In This Report:

- Globalization, Localization, and Cross-Channel: Benchmark 2012, March 2012
- Executing on the Promise: Retail Fulfillment 2012, July 2012
- The Relevant Store in the Digital Age: Benchmark 2013, May 2013
- Omni-Channel 2013: The Long Road to Adoption, June 2013

Appendix B: About Our Sponsor

GT Nexus

GT Nexus provides the cloud-based collaboration platform that leaders in nearly every sector rely on to automate hundreds of supply chain processes on a global scale, across entire trade communities.

GT Nexus enables many of the world's most iconic brands and retailers to expand visibility, improve margins, and support profitable growth. In fact, with over 25,000 suppliers, financial institutions, logistics providers, agents, retailers and brands operating in over 90 countries around the world, GT Nexus's track record of powering the supply chains of many of the world's leading brands and retailers is unsurpassed.

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Appendix C: About RSR Research

Retail Systems Research ("RSR") is the only research company run by retailers for the retail industry. RSR provides insight into business and technology challenges facing the extended retail industry, providing thought leadership and advice on navigating these challenges for specific companies and the industry at large. We do this by:

- **Identifying information** that helps retailers and their trading partners to build more efficient and profitable businesses;

- **Identifying industry issues** that solutions providers must address to be relevant in the extended retail industry;

- **Providing insight and analysis** about a broad spectrum of issues and trends in the Extended Retail Industry.