MULTICHANNEL MERCHANT

MCM OUTLOOK 2021

Solidifying the Pivots, Pursuing Efficiency

by **Mike O'Brien,** Multichannel Merchant

Where 2020 was all about reacting and pivoting quickly to meet massive disruption and shifts in consumer demand forced by the widespread lockdowns, 2021 has been about trying to find ways to make all these changes happen more efficiently from an operations perspective. But none of it has been easy, retailers and industry experts agree.

For footwear retailer DSW, one aspect of this has been finding more efficient ways to identify which store a local ecommerce order should be fulfilled from to optimize speed or reduce markdowns.

"We started learning things about being more flexible," said Steve Reade, DSW's director of distribution. "We weren't perfect, and it was messy, but we were willing to learn and navigate through it and I think benefit from it. But you can never be prepared for something like that."

Joe Gullo, senior director and head of global logistics for beauty and cosmetics seller Glossier, said post-pandemic consumers don't really care about channels – they just want to get their order in the best possible time and have a great experience, whether that's online or in store.

"More people were exposed to ecommerce than ever before, and a significant portion of market share won't go back, but some will," Gullo said. "Retailers need to make the entire shopping experience lifted up. And they need to give them a reason to come into a store, and it has to be more than, we have the stuff. Stack it high and let it fly is not going to work to get foot

traffic into the store."

And for retailers that were ill prepared for the digital shift that the pandemic induced, Gullo said they will continue to be challenged.

"If you don't have a flexible omnichannel approach, I don't know how you're still in business," he said. "Popular small businesses with a local following were forced to pivot. And if you're a bigger (retailer) who wasn't paying attention or didn't think the digital component of your business was important enough, you've probably been in trouble all year and will continue to be in trouble."

Emily Pfeiffer, a senior analyst covering commerce technology at Forrester, said the pandemic not only dragged retail into the future quickly but also forced solution providers to adapt rapidly as well to meet the technical challenges.

"The software companies didn't necessarily have solutions built into their OMS to support curbside, and suddenly they needed to," Pfeiffer said. "Retailers had to bring the experience but also the tech providers had

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to move quickly on their end. It was a good catch-up moment. Digital transformation and omnichannel had fallen away, but the pandemic removed any possibility you could leave them there. If you were a retailer not doing ship from store, when stores went dark you were in trouble. Things can't stay on the back burner anymore."

Operationally, the disruptions brought on by COVID-19 and the subsequent ecommerce boom have meant managing much higher shipping costs and tighter capacity, while dealing with a shortage of labor in fulfillment centers. And it has exposed weaknesses in companies that hadn't been investing in digital transformation before the pandemic hit.

Meeting Fulfillment Labor Challenges

Finding adequate labor in fulfillment and distribution centers has always been difficult, especially with steady double-digit growth in ecommerce and a ticking up of its overall share of the retail market. The past year has blown that up as a decade's worth of growth in ecommerce took place in a matter of months.

The U.S. unemployment rate, which peaked at 14.8% in April 2020, is now about 6% a year later. Economists say that figure is somewhat exaggerated as so many people without jobs aren't looking and don't figure in the calculation. The labor participation rate—those adults either working or looking for work—is at 61.5% from 63.3% before the pandemic, a decline of nearly 3.9 million people.

According to the 2021 MCM Outlook survey, 45% of respondents said they were facing wage pressure in their fulfillment operations, including from Amazon and its hundreds of facilities and growing across the U.S. Both as the move toward a $15 minimum wage grows and labor demand pushes costs higher, companies large and small are being impacted.

Perry Belcastro, Senior Vice President of Fulfillment Services for Saddle Creek Logistics Services, said the past year has been extremely challenging across the board from a labor standpoint. This is especially true in sourcing and retaining enough hourly associates to handle the surge in ecommerce order volume, which had been growing steadily even before 2020, especially in direct to consumer (DTC).

"Securing sufficient labor to handle increasing volume has always been a big hurdle for warehouses," Belcastro said. "When you combine that with recent stimulus activity, it definitely has made hiring more challenging across the logistics industry. Rapid growth has also increased the importance of finding key leadership to oversee operations, ensure peak performance and manage growth. To help attract the right people, we've focusing our recruiting efforts more around company culture and our reputation in the marketplace since that's a differentiator for us. Marketing for recruitment is now just as important as marketing to potential clients."

Doug Smith, Vice President of Supply Chain and Logistics at western wear retailer Shepler's, said it's a struggle to get enough people onboard to do the work in his fulfillment operations, given labor shortages. "The biggest competitor now is the federal government," Smith said. "I'm having a hard time competing with unemployment plus $300 per week. We get a decent flow of applications but they're not turning into hires. Either they don't show up after their interview or don't show up for work."

On the West coast, Smith said, the issue is even more pronounced, with a 50% wage differential compared to the Midwest, up from 30% before the pandemic. "We don't have Amazon in Wichita, but they're putting finish touches on a facility now," he said. "I expect to see the same issues there as the West coast."

To address the labor issue, Smith said Shepler's has spent the past three years automating one facility, while getting ready to launch a big project in another. "The word I've been using is labor dependency," he said. "You need to find a way to decouple volume and throughput directly to labor, in order to lessen that dependency. Automation eases the physical burden and increases throughput. In my world right now, if I want to ship 100 units, I have to spend one labor hour. What I

need to get to is one labor hour for 300 units. I have to break that dependency and strict ratio. It's not sustainable in this model."

Even the ROI calculation on automation and robotics is changing, Smith said, and can't be strictly labor based. It has to take into account capacity, throughput and use or non-use of additional space. Because automation is more expensive, it can't just be, spending X to reutilize 10 full-time associates. "It's how much improved throughput, because of that increase in capacity, in less square footage," Smith said. "In retail or ecommerce, a DC sits at a resting heartrate, and for five weeks goes up 5x. So, the value of going up 5x without adding 5x people is the new ROI calculation."

When asked about the value of warehouse automation and robotics, 27.5% of respondents to the MCM Outlook survey said it was to gain operational efficiency, 17.5% said it was to reduce headcount or labor dependency, while 60% said it was a combination of both.

Do you consider fulfillment automation a way to:

*Gain operational efficiency (**27.5%**)*
*Reduce headcount or labor dependency (**17.5%**)*
*A combination of both (**60%**)*

Source: MCM Outlook survey, April 2021

At DSW, Reade said the increased demand for labor has been addressed by spreading out a larger portion of ecommerce order fulfillment among the company's 500 stores, rather than concentrating it all at the fulfillment centers. So instead of having to hire 3,000 associates at the FCs to handle a demand spike, it's a matter of hiring 3-6 in a metropolitan area with a concentration of stores. This was especially critical when stores were closed to shoppers and flipped to distribution hubs.

"It's had a big impact," Reade said. "Using stores helps in that respect, instead of doing one high-intensity, single-point solution, it's really distributed out across the floors. You can work with people's schedules, with their responsibilities during those few days when you see those spikes, and it makes a big difference for us."

Belcastro said Saddle Creek is investing in automation technology at a new facility in Walton, KY, anticipating high ecommerce order volume. He noted that lead times for many automation projects, between design, purchase and installation, have gotten longer due to greater demand. Automated mobile robots, or AMRs, are more readily available.

"An advantage of AMRs is that you can get up and running faster," he said. "They allow you to be more nimble and more strategic and better manage volume and labor. But you need to make sure you have the right environment and the type of product and operating profile that can benefit from AMRs. Not everyone does."

Addressing Rapidly Rising Shipping Costs

Kenneth Moyer, Vice President of Supply Chain Strategies at LJM Consultants, said the major carriers are definitely still in the driver's seat in terms of leverage in negotiations due to capacity issues, although it's not quite as pronounced as in the fourth quarter of 2020. He said they have already warned shippers to expect more of the same during the 2021 peak.

"In 2020 both FedEx and UPS had constraints, although it was more pronounced at UPS," Moyer said. "Because of the 2019 decouple from Amazon, FedEx had a bit more capacity to absorb. But there were definitely instances of both limiting capacity, a lot was based on geographic location and asset allocation."

Thomas Andersen, a partner with LJM, said 2021 represents the perfect opportunity for UPS to follow suit and break its ties with Amazon and the discount rates it commands, especially considering the amount of volume available in the market and Amazon's growing reliance on its own logistics. Experts estimate UPS handles about 10%-12% of Amazon's volume, while Amazon itself handles as much as two-thirds.

"I wouldn't be shocked this year if they were able to do so, but I don't know the

details of that agreement," Andersen said. "But given amount of volume out there, the last thing UPS needs is Amazon volume. If ever there was a time to break that relationship, if they're able to do so, now is that time, because of capacity constraints."

Gullo said he didn't like the juxtaposition of rising shipping costs from new charges piled on top of charges, and the stellar financial performance of the major carriers.

"We ship thousands of packages a day, and I think it's outrageous that carriers are still charging peak surcharges a year later, simultaneously with presenting record earnings to Wall Street," Gullo said. "Those two things don't make sense and they are wrong. Some major carriers had record earnings, and continue to roll out a significant peak surcharge, across even the cheapest services. Clearly something opportunistic is happening there."

For all these reasons, Belcastro said it's more important than ever for shippers to manage their transportation costs by using good data and analytics around parcel shipping. This includes understanding what's driving the cost in the shipping profile, whether it's the size of the item, something hazardous or an odd shape.

"It's important to have packaging that fits your product, so you don't have excess space driving up the cost," he said. "Also, use the right service levels and list options clearly on your site. Some customers don't want to pay as much for shipping, so they're willing to wait 3 to 4 days. If they want next day, then price it accordingly."

Smith of Shepler's said the importance of having good shipping data became even more critical in the past year with the addition of new peak charges and accessorials from the major carriers, which couldn't just be added into his rate shop tool.

"As a shipper you had to decide, how do I account for that?" Smith said. "In some cases, the surcharges increase the package cost by 30% or better. It's not just a matter of adding $3 to every SurePost package, there are all different levels and tiers to make it almost impossible to account for. We were able to average out projected service levels and carriers for each package, giving us an idea of what the surcharges looked like, then average that into the rate shop so we captured reasonable costs into the manifest. Without good data, that never happens."

The rapid rise in shipping costs for ecommerce has made a multi-carrier approach a must-have strategy to ensure the best rates possible across all shipments. But it can get complicated, according to LJM's Moyer.

"When you're managing a multi-carrier environment, you have revenue commitments from each and contracts with each," he said. "You have to make sure each carrier is getting the right amount (of volume) to get the best rate. And that means having good data and a good system to give you back the right information to make real-time decisions, some of it monitored hourly. It's more complex today by multiples."

In the last mile, providers like DoorDash, Postmates and Instacart are all experimenting with ways to combine their bread-and-butter restaurant and grocery delivery with parcel to both win more business from retailers and make the service more economical for customers and profitable for them.

Dean Maciuba, a managing partner, North America for Last Mile Experts, said the gig delivery app providers are offering parcel combined with food delivery in select markets, but not advertising it yet. Walmart in particular has been testing it out, he said.

"It's all about the scale," Maciuba said. "If they can somehow connect or bundle three separate services within a single offering, conceivably they can drive economies that drive down the cost. It's still an open question."

He noted how last-mile providers can use gaps between high-demand periods for food and grocery to facilitate parcel delivery. Or they can add in parcel orders to build up route density and improve the economics.

"On demand-delivery is fairly costly, so the only way to bring that down is to create more routes or density for the drivers," he said. "So instead of 1-2 stops, it's 4-10 stops before they go back and replenish."

Making Omnichannel Happen More Economically

The retail industry as a whole was forced to suddenly go omnichannel in March 2020, even if many of them hadn't been doing so previously. This led to a lot of painful transitions, as companies quickly cobbled together strategies for buy online pickup in store (BOPIS), curbside pickup and ship from store, rapidly investing in and standing up new systems and processes.

These tactics became a lifeline for many, however, as closed stores were now tasked with becoming fulfillment hubs to keep orders flowing as foot traffic ground to a halt. And the lessons learned have proven valuable even after stores have reopened, because many shoppers are opting to continue purchasing online. Data from Placer.ai showed that overall foot traffic at dozens of apparel retailers was up just 3% in Q1 2021.

Profit Margin on a $100 Sweater

Fulfillment Channel	*Operating Margin*
Ship from distribution center	$36
In-store purchase	$33
Buy online, pickup in store (BOPIS)	$23
Curbside pickup	$23
Ship from store	$17

Source: AlixPartners

Adam Pressman, a managing director at AlixPartners, said retailers are looking for ways to improve the economics of ship from store in particular, as it is the most expensive form of omnichannel fulfillment with all the added incremental costs of labor and last-mile delivery. AlixPartners estimates that the operating margin on a $100 sweater shipped from store is just $17, compared to $23 for curbside or BOPIS, $33 if purchased in store and $36 if shipped from a fulfillment center.

"The stores are not always configured for store employees to handle ecommerce orders, or for staging of product as curbside and BOPIS demand increases," Pressman said. "We've definitely seeing retailers trying to think differently about the physical store layout, to batch orders and make the picking process more efficient."

One approach is to pool orders from a number of local stores at a regional sortation center, Pressman said, as Target is testing out at its Minneapolis headquarters. Creating so-called "dark stores" that just operate as fulfillment hubs is another, or creating hybrid retail/order fulfillment locations as Best Buy is doing. All of this requires the operating logic of a state-of-the-art order management system to orchestrate the flow to and from the right place.

"As they're understanding the demand, where their customers are, some of this does make more sense to have locally, so you can really drive efficiency and effectiveness, as you pool product together and inventory and those kinds of tasks," Pressman said. "You can also structure the shipping arrangements, bringing as many products together as you can. That's how they need to think about having inventory that creates incentives for both stores and customers to optimize omnichannel."

Reade said DSW is working to make fulfillment from its stores "feel and act" more like it would from an FC or DC, including realizing synergies of labor efficiency and inventory control. This includes aligning orders to drop against certain stores, consolidating volume to capture shipping rates similar to those at a central facility. He added DSW is testing out its own central hub fulfillment strategy, although using a different approach than Target.

"The systems in place needed to be improved," he said. "We're going on a journey of realigning store systems, including how we manage inventory in the field. If we can overcome (the store labor and transportation issues), then it's about how to deploy inventory to the stores. What you're left with hopefully is an efficient place to fulfill from that's closer to your customer so the experience is better."