Pulse of the Omni-channel Retailer

How retailers are adapting to the
changing needs of the flex shopper

Table of Contents

Introduction

Retailers across Europe are transitioning from traditional channel-centred sales and execution models to much more complex models that bring together multiple sales channels and multiple inventory and delivery systems: the new world of 'omni-channel' retail. Retailers of any size face considerable challenges in adapting and often rebuilding the logistics and information systems that underlie their businesses, and the quality of the models they create will be absolutely critical to business success in the future.

In 2015 UPS released its research into the changing preferences and habits of the European consumer (the *UPS Pulse of the Online Shopper*) which demonstrated the increasing demands and expectations of the new generation of retail consumers, the 'flex shopper'. In 2016 the latest survey, the *UPS Pulse of the Omni-channel Retailer*, is designed to look at what European retailers are doing today to respond to the needs of the flex shopper through logistics management.

Methodology

This consultation paper provides a current, data-based picture of how far retailers have moved to meet the key challenges they face when adapting their business to the demands of the flex shopper, and an analysis of the strategic requirements of the coming period. Retail success is dependent more than ever before on fulfilment. All retailers are likely to evolve their logistics approaches significantly, and for many, this is not so much an issue of refinement as an issue of survival.

The *UPS Pulse of the Omni-channel Retailer* survey suggests that there are four important themes in the strategic rebuilding of the European retail logistics universe. We do not claim that the four themes are comprehensive – but they are certainly essential. Companies that address all four of the areas of concern are more likely to be ahead of competitors who do not prioritise these areas of change.

In the search for a better understanding of the transition towards an omni-channel approach to retail sales execution and fulfilment, UPS commissioned the *UPS Pulse of the Omni-channel Retailer* survey (2016) covering Belgium, France, Germany, Italy, the Netherlands, Spain, and the UK. The 2016 survey fielded by IDC Retail Insights forms the data basis for this consultation paper:

- conducted through telephone interviews in the native language of each country;
- a sample target of 100 respondents per country (total = 707);
- interviews conducted between January and March 2016;
- interviewees were senior business and operations executives, including those responsible for supply chains, logistics and e-commerce;
- survey covered both direct retailers and upstream retail manufacturers in apparel, consumer goods and high-tech industries.

1 The omni-channel transition

Once logistics followed the sales channel, and the number of sales channels was limited. Today, there are multiple channels – store sales, franchise sales, online through own websites, online through market places or third-party sites, and sales through traditional mail or telephone order processes – and any one of these may have a range of different fulfilment options. The shopper who walks through the door and carries the purchase away may well become the minority. How should retail companies shape their total retail offer and build the logistics and IT machinery to fulfil that offer? Recent IDC Retail Insights research shows that 64% of European retailers consider themselves to be in the process of omni-channel transformation, but only 25% have an optimised omni-channel inventory process to reap all the benefits from this transformation.

2 Rethinking the store

What is the brick-and-mortar store for? Retailers have long focused on their store presentations to project their retail brands, and to craft customer experiences. Today they have to go beyond the traditional store experience, and use it as part of the inventory and distribution network, as service hubs as much as showrooms and sales theatres. Yet despite the recognition of the changing role of the store, only 19% of retailers are leveraging the store network as a fulfilment centre to address the needs of the customer.

3 Succeeding through product availability and consumer convenience

One of the quickest ways to lose a retail customer is to present them with an 'out of stock' situation and not offer a compelling alternative. Earlier research from UPS has shown that faced with an out-of-stock item, 41% of European consumers will go to a competitor's website or app and 20% will go to a competitor's physical store to find the same or similar product, while only 17% say they are willing to buy and wait. The current research shows that online retail channels are increasingly responsive to out-of-stock challenges while physical store channels are lagging.

4 Making reverse logistics work to your advantage

It is widely recognised that managing returns is a key success factor, especially in retail channels where the customer typically orders remotely. Customer confidence and brand integrity depend on efficient returns – but making reverse logistics economical is often a much greater challenge than managing outbound deliveries. Retailers say their key challenges in this area are managing defective goods (64%) and performing quality checks on returned goods for resale (50%). The UPS Pulse of the Omni-channel Retailer survey shows that almost all retailers (92%) believe that third-party logistics providers (3PLs) will play a primary role within the process.

Behind these challenges lies a simple and transformative fact of modern retailing. Customers – not products – are now at the centre of retailing. The customer has taken control – control of information, control of sales channel choice, control of who to buy from, and on what terms. Retailers that confront this reality and capitalise on it are the retailers who will flourish in the new retail environment.

Responding to the flex shopper

At UPS we call the new digitally-enabled customer the 'flex shopper'. This is the new breed of retail consumer that has been created by the online revolution, and shaped by the new price and value consciousness that developed in the wake of the credit crisis.

Flex shoppers are consumers that have constant access to price and availability information, who have access to multiple sales channels and will use whichever best meets their needs, and who use social networks to compare and judge retail offers. They exemplify the way that choice and flexibility has passed to the consumer, and the way that retailers now have to work much harder to retain their customers in this online, digitally-enabled world. Our early research showed us that in particular, flex shoppers value price, checkout speed, convenience, multiple delivery options, and clear and easy to manage return policies.

IDC Retail Insights supporting the latest research bring us the evolving expectations of the flex shopper:

- Tired of the traditional shopping experience
- Willing to explore new engaging omni-channel shopping experiences
  - o   Stores will not die, but they will evolve
  - o   Online is evolving further
- Demanding personalisation at all levels
  - o   Product, location, engagement, experience
- Looking for a more proactive retailer
  - o   More value added services: Click & Collect, reserve, chat
  - o   More digitally enabled

- Increasing demand for flexible fulfilment options
  - o   Delivery at an address of their choice is key
  - o   Collection points (post office, lockers etc.) increasingly requested
  - o   Click & Collect becoming the industry standard
- Faster, cheaper, and smoother fulfilment
  - o   Free delivery
  - o   Next day, non-working day delivery
- Access to post-shipment services
  - o   Re-routing, changing delivery date

The flex shopper environment has profound implications for the role of the brick and mortar store. Store locations are no longer the primary physical marketplace for sales transactions. Instead they are increasingly being used as showrooms, fulfilment centres for online orders, and delivery/collection points. But there are even bigger implications for the underlying processes of inventory management, orders and fulfilment. The flex shopper is breaking down the barriers between channels and geographies that retailers have long been accustomed to, and forcing companies to adopt much more flexible and integrated approaches to respond to that change.

Breaking down the challenge

The challenge of the omni-channel transition in retail is comparable to challenges confronting many businesses faced with the digitalisation of the economy. Information has become universally accessible. Consumers have become more powerful, with greater choice. Automation and integration of information and processes has become ever more achievable, meaning that companies that do not meet this challenge fall behind.

In retail this is evidenced by the breakdown of the channel-based approach to organisation and execution when it comes to inventory, orders and fulfilment. Customers are not interested in channels, they are interested in cost and convenience, and they can no longer be expected to behave in the segmented, channel-friendly way they may have done in the past.

For retailers the first step in responding to this new reality is understanding consumer behaviour, which will help them craft a data and inventory management architecture that reflects behaviour. And when it comes to the logistics offer to consumers – things like multiple options on home delivery, store delivery, third-party drop-off locations, and the returns offer, all of which give the consumer the opportunity to trade off speed, location and price – both companies and consumers have a shared interest in the right combination of efficiency, visibility, and flexibility.

Retailers are unlikely to be able to deliver all that the consumer demands entirely on their own. This is why the ability to collaborate effectively with third-party logistics providers (or '3PLs') and integrate with their IT structures is also critical. This too is part of the omni-channel transition, which is not only about integrating the data and resources of the retail company, but also the resources of many providers. Clearly there are multiple challenges implied by this transition. However, the *UPS Pulse of the Omni-channel Retailer* survey suggests that four should be top of the retail agenda.

The omni-channel transition

The results of the *UPS Pulse of the Omni-channel Retailer* survey show that the majority of European retailers are trying to transition from inventory, order and fulfilment systems that focus on single channels and segmented concepts of the consumer, to an omni-channel approach that recognises that consumers now shop across channels and that the hidden machinery of retail has to respond to these flex shoppers and provide the same experience irrespective of the channel. It's a challenge, and most retailers are not getting there yet. The current research shows the extent of the gap between ambition and execution: 40% of companies say that omni-channel fulfilment is currently a significant challenge for their business, and over 30% of companies say they face big challenges in investing enough in IT, organising logistics, understanding consumer behaviour and making management responsive to omni-channel approaches.

The building blocks of all legacy operating systems within retail are inventory, order management, and fulfilment. In the past these functions tended to be discrete, and were focused on channels – so there would be one inventory

Omni-channel transition key challenges

Thinking about the potential challenges that organisations are facing in transitioning to a fully omni-channel and digitally enabled business model, which of the following do you think are the biggest challenges?
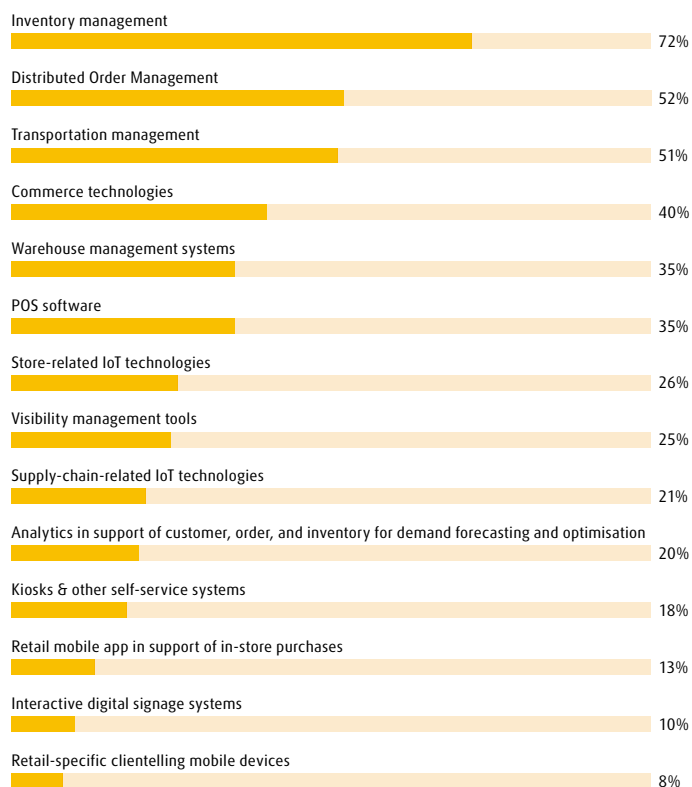
Fulfilling customer orders when they want and where they want
40%

Amount of capital investment or operating expenses required to align IT
33%

Having a well organised flow of goods internally and externally
33%

Understanding, and mapping, the digital behaviours and expectations of customers/clients
31%

Breaking the silos within the organisation
31%

Top five answers

Source: Pulse of the Omni-channel Retailer survey

Logistics investment priorities

With regards to logistics and fulfilment of delivery to customers, is your organisation planning to invest in any of the following technologies in 2016?

Inventory management
72%

Distributed Order Management
52%

Transportation management
51%

Commerce technologies
40%

Warehouse management systems
35%

POS software
35%

Store-related IoT technologies
26%

Visibility management tools
25%

Supply-chain-related IoT technologies
21%

Analytics in support of customer, order, and inventory for demand forecasting and optimisation
20%

Kiosks & other self-service systems
18%

Retail mobile app in support of in-store purchases
13%

Interactive digital signage systems
10%

Retail-specific clientelling mobile devices
8%

Source: Pulse of the Omni-channel Retailer survey

and order system for physical stores, one system with additional fulfilment elements for catalogue sales, and more lately one for online channels. Systems were usually geographically streamed as well, so orders from one geographical location could not routinely be matched by products held in a different location.

Retailers have recognised for some time now that this 'siloed' approach to retail management was out of sync with the emerging behaviours of the flex shopper, and also out of sync with the integration capabilities of modern cloud-based IT and collaborative supply chain management. As a result retailers are striving to implement a much better integrated multi-channel, multi-location management approach, something that is often called 'Distributed Order Management'. That is a loose term capable of different definitions, but the goal is always the same – to move closer towards an 'order-from-anywhere, fulfil-from-anywhere' capability.

This omni-channel transition implies many challenges. It is likely to involve investments in real-time inventory visibility and in integrated fulfilment systems (and both of these may include integrating third party logistics and inventory management suppliers) as well as an order architecture that brings everything together in a single orchestration platform. The *UPS Pulse of the Omni-channel Retailer* survey shows that this shift is creating a new agenda of supply chain and fulfilment challenges for European retailers.

The *UPS Pulse of the Omni-channel Retailer* survey shows that European retailers have extensive technology investment plans for 2016. The top three technologies that retailers plan to invest in are all related to supply chain execution and confirm the focus on omni-channel fulfilment.

- 72% of companies are investing in inventory management.
- Just over half of companies (52%) are investing in Distributed Order Management.
- Just over half of companies (51%) are also investing in transportation management.

Rethinking the store

Most large retailers are now multi-channel retailers. The physical store, while operating from a position of strength, no longer plays the central role it did in the recent past. It may be a unique channel, it may be an essential channel, but it no longer dominates the sales channel mix: for many retailers, the store now has to adopt additional roles in sales execution and fulfilment.

We already know from recent UPS research that while the majority of consumers still prefer to shop in-store, that trend is starting to drop. When asking frequent online shoppers about their most frequent engagements with multi-channel retailers, some 42% of these consumers said they search online and buy online, while only 20% most frequently search in-store and buy in-store. Small but significant numbers of consumers (7%) typically search in-store and then leave the store to buy online.

Even where consumers do choose to shop online, the store remains an important part of the customer experience. For example, almost half of all consumers who purchase items online have opted to collect in-store at some point, and three in ten consumers have made additional purchases during those trips. A large majority (81%) of consumers respond positively to being able to return goods to the store irrespective of how the product was purchased, and almost half of consumers (47%) have used Click & Collect at some point. Online shopping has not superseded the store, but has evolved around it. Consumer demand is pushing retail stores into becoming fulfilment centres as well as sales theatres.

The Click & Collect opportunity

Click & Collect is important because it offers delivery choice to customers, helps bring customers into the store for potential additional purchases where collect is at the retailer's own store, and at the same time can help retailers reduce last mile delivery costs. While being widely adopted in food and grocery retail, Click & Collect is also becoming significant in non-food retail. For example, leading UK general retailer John Lewis recently reported that 56% of all online orders are collected at stores.

Source: John Lewis Partnership PLC, Annual Report and Accounts 2016

Three key challenges

What are the challenges likely to be faced in setting up a Click & Collect/reserve service for your organisation?

Challenge	%
Dealing with uncollected parcels	67%
Accepting and/or managing returns	57%
Difficulty managing customer notifications	48%

Source: Pulse of the Omni-channel Retailer survey

The changing role of the store network is a primary driver for new strategic initiatives on inventory management and supply chain execution. The *UPS Pulse of the Omni-channel Retailer* survey data show that in addition to selling local stock, eight out of ten retailers intend to leverage the store as a showroom for displaying products that are available in the network – some retailers call this the 'endless aisle' approach, where the entire range of products available in the network can be offered to customers without carrying local stock in the store.

Moreover, half of all retailers intend to use the store network to provide value added services to customers, such as Click & Collect or online return services. Almost one-third (27%) of European retail companies already use stores as fulfilment centres for online orders.

However, there is a significant gap between retailers' plans for omni-channel transformations and their current inventory management capabilities. 75% of companies are still managing inventory stock in a traditional manner with a fixed amount of inventory in every node of their supply chain. This disconnect becomes even more evident in inventory stock management practices across different channels: the majority of retailers (54%) are still using owned warehouses to regularly fulfil stores, while only 19% are already leveraging the store network potential to provide more flexible and immediate responses to customers' requests. Only 25% of retailers are already using an 'optimised' omni-channel inventory management process that gives them access to real-time inventory data across all their sales channels and the ability to fulfil orders across channels.
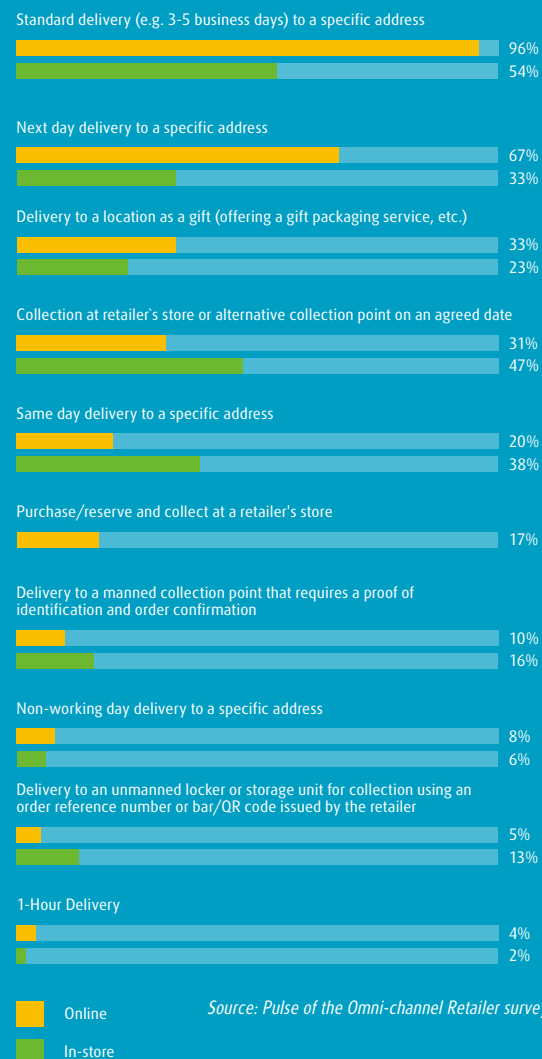
The results of the *UPS Pulse of the Omni-channel Retailer* survey show that delivery and collection options for in-store buyers are fewer compared to online shopping. However, some delivery options (such as same day delivery to a specific address) are more likely to be offered by retailers in-store compared to online: it appears that retailers are expanding delivery options for online first, and then gradually extending the offer to store customers.

The store as delivery node

The *UPS Pulse of the Omni-channel Retailer* survey shows that retailers are focusing on expanding delivery options for in-store as well as online purchases (see graphic below). But are they doing enough in-store, given that consumers demand flexible delivery options and still prefer store shopping over all other options?

Store delivery services

Which of the following delivery services does your organisation plan to offer customers in the next 12 to 24 months when buying products online and in a physical store?

Standard delivery (e.g. 3-5 business days) to a specific address
- 96%
- 54%

Next day delivery to a specific address
- 67%
- 33%

Delivery to a location as a gift (offering a gift packaging service, etc.)
- 33%
- 23%

Collection at retailer's store or alternative collection point on an agreed date
- 31%
- 47%

Same day delivery to a specific address
- 20%
- 38%

Purchase/reserve and collect at a retailer's store
- 17%

Delivery to a manned collection point that requires a proof of identification and order confirmation
- 10%
- 16%

Non-working day delivery to a specific address
- 8%
- 6%

Delivery to an unmanned locker or storage unit for collection using an order reference number or bar/QR code issued by the retailer
- 5%
- 13%

1-Hour Delivery
- 4%
- 2%

■ Online
■ In-store

Source: Pulse of the Omni-channel Retailer survey

9

Succeeding through product visibility and customer convenience

Previous UPS research has shown that one of the most common ways of losing a customer is when products are out-of-stock. Some 41% of online consumers will go to an alternative retailer if an item is not available, and over half (58%) have abandoned online purchases if no delivery date is provided or delivery times are too long. The challenge for retailers is firstly to reduce the number of out-of-stock instances, and secondly to turn unavoidable out-of-stock situations into sales.

Delivery time information – even when delivery times are extended – is crucial to holding on to the customer. Retailers that have real-time inventory visibility across the network (in stores, warehouses and via third parties) can inform customers of product availability and fulfilment options with a committed delivery or collection date, avoiding lost sales and ensuring customer trust for the long term.

At present retailers' approaches when facing out-of-stock situations are fundamentally different in-store and online. In physical stores the approach is more traditional, with the majority of companies (78%) proposing the purchase of a similar product or suggesting customers wait for the specific product re-stock without providing any notification (45%). Omni-channel approaches become more evident online, with 68% of companies adopting order tracking and delivery to the customer's preferred address when the product becomes available and 59% tracking the order, and informing the customer about availability in a store or online.

The results of the *UPS Pulse of the Omni-channel Retailer* survey show that retailers do have pro-active approaches for turning around out-of-stock situations in their online businesses, but need to incorporate similar protocols in their in-store settings as part of the omni-channel transition.

Absorbing the cost of free delivery

Free delivery for online and store purchase is now offered by the vast majority of companies, but retailers impose some limitations on delivery availability to control costs. While 72% of companies offer free delivery with a minimum order threshold and 61% offer free delivery only on selected products, 9% of companies only offer free delivery for every order without limitation. Most companies are covering the cost of free delivery through savings in other areas of the company, although a small proportion are passing costs on to product pricing or financing delivery through subscription to a premium service.

Cost allocation for delivery

How does your organisation absorb free delivery costs?

|	
Covered by savings in other areas of the organisation	59%
Spread over the cost of products	23%
Offered upon a yearly subscription to a premium/member service	13%

Source: Pulse of the Omni-channel Retailer survey

Make reverse logistics your advantage

The flex shopper is a customer whose loyalty may easily be swayed. The traditional link between consumer and physical store which built and maintained customer loyalty has long broken down: today retail consumers can browse and use multiple retailer offers on a mobile or desktop device and have little inhibitions about changing channel when it suits them. Retention of customers has therefore become a primary concern of retail strategists.

Source: Pulse of the Online Shopper
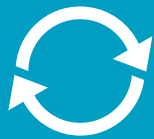
53%

of shoppers are satisfied with the ease of making online returns/exchange
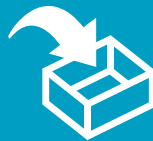
34%

of consumers want to see a returns label right in the box

58%

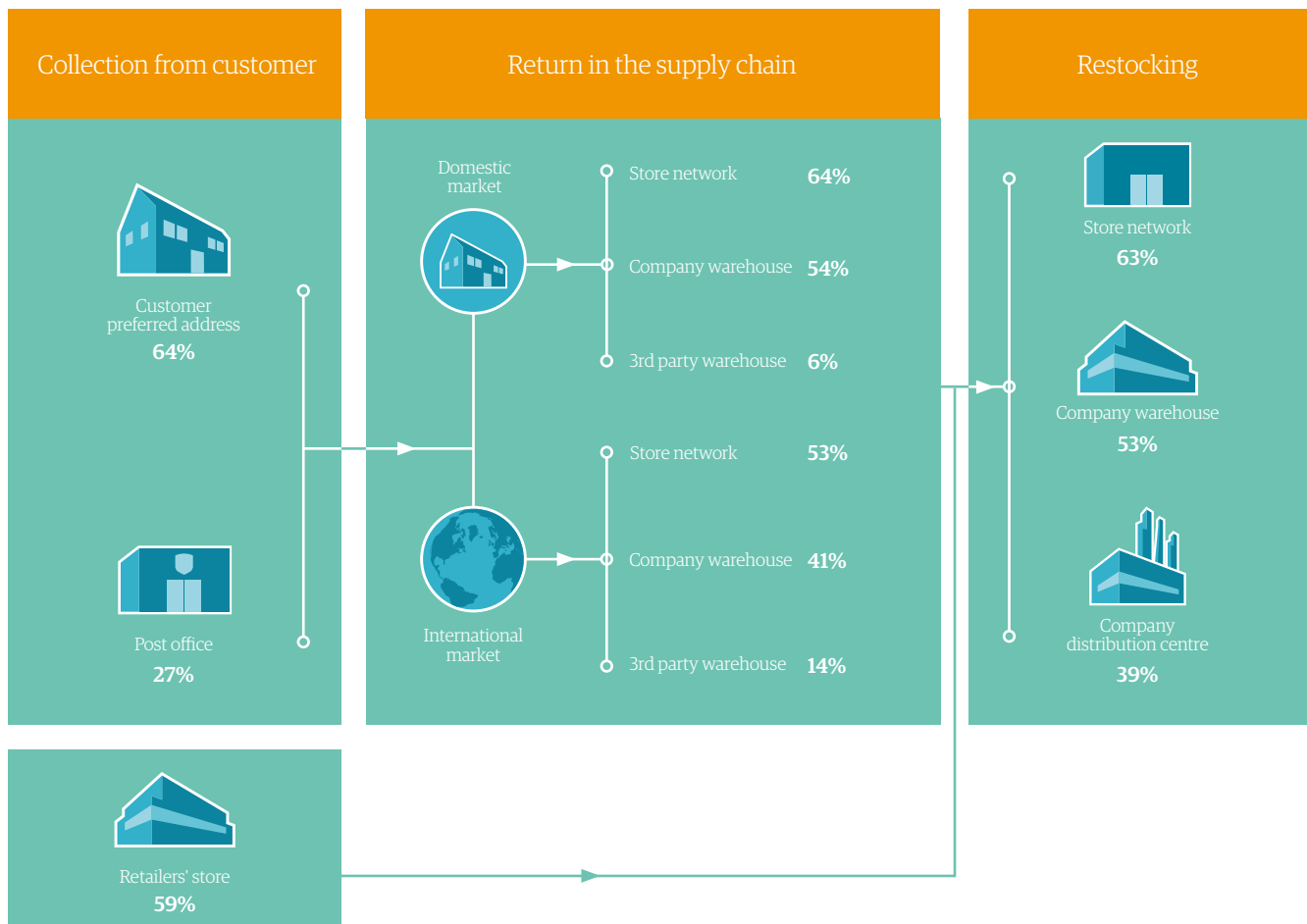say free return shipping is key to a positive returns experience

Returns remains an area highly valued by consumers

Earlier research by UPS has demonstrated that there are multiple engagement points where a retailer can lose a customer – and they are almost all related to inventory, ordering, and the critical issue of returns. Retailers that want to win and retain customers have to integrate returns into the omni-channel offer, but management of returned products is also a challenge because it is a costly and highly distributed process involving stores, warehouses, third-party logistics providers (or '3PLs') and other third parties.

A graphic illustration of the survey's findings on the complexities of the returns process from product collection through return management to re-stocking is provided below, picturing the reverse logistics journey of European retailers, where percentage numbers indicate the percentage of companies opting for a specific return management choice. Products are typically collected by a courier from a customer address or at a store and - for both domestic and international markets - are firstly returned into the supply chain through the store network and company-owned warehouses. Products are then restocked again in most cases through the store network, company warehouses and company distribution centres.

The reverse logistics journey

Collection from customer	Return in the supply chain	Restocking
Customer preferred address **64%**	Domestic market → Store network **64%**	Store network **63%**
	Company warehouse **54%**	Company warehouse **53%**
	3rd party warehouse **6%**	Company distribution centre **39%**
Post office **27%**	International market → Store network **53%**	
	Company warehouse **41%**	
	3rd party warehouse **14%**	
Retailers' store **59%**		

Source: Pulse of the Omni-channel Retailer survey

What are the key issues for companies mapping the reverse logistics journey? The *UPS Pulse of the Omni-channel Retailer* survey suggests that retailers find the biggest challenges in managing inward inventory in stores and warehouse/distribution nodes, rather than in designing effective logistics.

· Challenge: managing defective/damaged goods (64% of companies).
· Challenge: performing quality checks (50%).
· Challenge: optimising and standardising labour force activities (41%).

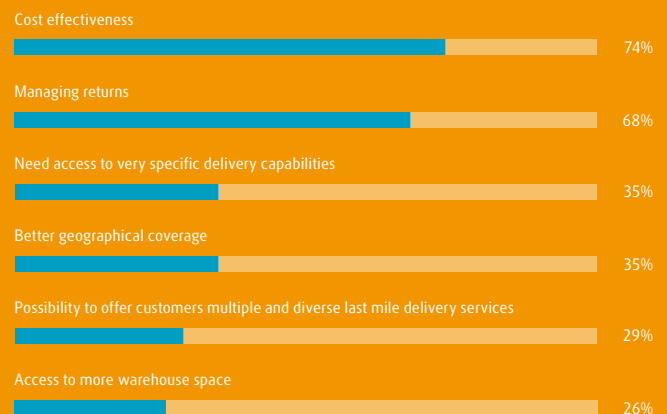*Source: Pulse of the Omni-Channel Retailer survey*

These results suggest that companies should consider it a priority to identify the nodes where they can most efficiently verify product quality and redistribute products accordingly. It is likely that retailers will also need to collaborate closely with 3PLs as they can support returns efficiency and help with accuracy and speed throughout the reverse logistics journey.

Managing logistics through 3PL collaboration

Managing orders, reservations, shipments, and inventory in multiple locations, providing flexible delivery and collection options, and dealing with uncollected parcels and returns, all while ensuring performance to customers and profits to shareholders is becoming an ever more complex challenge for every retailer. In most cases meeting this challenge depends on effective collaboration with 3PLs, and the *UPS Pulse of the Omni-channel Retailer* survey shows that almost all European retailers (92%) believe that 3PLs will continue to have a primary role in the process. A significant percentage of retailers (45%) choose to work with multiple 3PLs as compared to just a single 3PL in order to win cost efficiencies and better manage the return process across countries or at country level.

Why is your organisation leveraging multiple third-party logistics providers across countries or at country level?

Cost effectiveness	74%
Managing returns	68%
Need access to very specific delivery capabilities	35%
Better geographical coverage	35%
Possibility to offer customers multiple and diverse last mile delivery services	29%
Access to more warehouse space	26%

Source: Pulse of the Omni-channel Retailer survey

Conclusion

The rise and evolution of the flex shopper is changing retail practices at every level of the business. Many consumers have already abandoned the channel-specific shopping behaviours of the past. Retail companies are engaged in a race to respond to the new realities.

Companies say that delivering on the overall **omni-channel transition** is the biggest issue they face. But there are more specific challenges on their agenda too: they have challenges in investing enough in IT (actual design of omni-channel IT appears to be a much lower priority), in understanding consumer behaviour, and in restructuring management around an integrated omni-channel model. It is also notable that more than a quarter of companies cite the challenge of integrating a single data view of stock and customers, and of order orchestration in a retail world where old channel distinctions are breaking down.

The **store network** is evolving into part of the omni-channel offer, and some practices seen in online business are migrating to stores. The majority of shoppers still prefer to shop in-store, and half of all retailers say they intend to use the store network to provide value added services to customers, such as Click & Collect or online return services. More than a quarter (27%) of European retail companies already use stores as fulfilment centres for online orders. Yet companies are finding it hard to integrate online and store services like Click & Collect: leveraging the store as part of an integrated omni-channel system is still a goal, not a reality – and companies recognise this, with over 50% intending to invest more in inventory management and distributed order management.

Retailers continue to face challenges in creating a coherent offer to customers when wanted products are **out of stock**. Retailers seem to be better at dealing with out-of-stock situations online than in-store, where alternative product offers or specific data on restocking times are less evident.

Lastly, effective **reverse logistics** remains a key decision point for buying – but the evidence is that companies still need to identify where they can most efficiently check and redistribute returned goods. Better collaboration with third party logistics suppliers (3PLs) may be the key – over 90% of companies believe 3PLs should have a primary role in the logistics process.

The *UPS Pulse of the Omni-channel Retailer* survey shows that retailers want to move towards omni-channel integration, and have specific investment and restructuring plans to do so. Companies recognise that the flex shopper is more demanding, has more information and choice, and is willing to use that choice. But the omni-channel retail response remains a work in progress.

From figuring it out to getting it done, we're here to help
www.**ups.com/solutions**