

International fulfilment challenges for the next decade

by Alan Braithwaite and Martin Fletcher

Retailers such as ASOS and John Lewis are making public forecasts of future growth in their on-line revenues of more than 30 per cent per year and setting targets of £1billion over the web in five years. The numbers show that these forecasts are not fanciful. There are already some billion pound players in the form of Amazon, TESCO and DSGi with NEXT pushing strongly towards this target. Many have businesses that are delivering revenues of £200-400million; others are still testing the water with their offers.

LCP's benchmarking shows a wide variation in on-line's share of revenues but a figure of 10 per cent is not atypical. Looking back to the forecasts made in 1999, Forrester predicted an on-line share of 10 per cent of all retail by 2005; in the context of few precedents at that time, they were close albeit a little premature. When you consider current growth rates, the trajectory of these original forecasts are being proved right.

The attainment of reliable and cost effective fulfillment is a major factor in the drive for growth. The need for care in design and planning as well as operational execution for quality service are in powerful tension with the economic imperative for low cost. Reliability is crucially important as the worst stories of poor customer experience are a haunting reminder of the brand and financial damage that can be sustained when it goes wrong, attracting media attention. But cost efficiency is vital as on-line margins are under increasing pressure and multi-channel retailers are seeing store performance eroded.

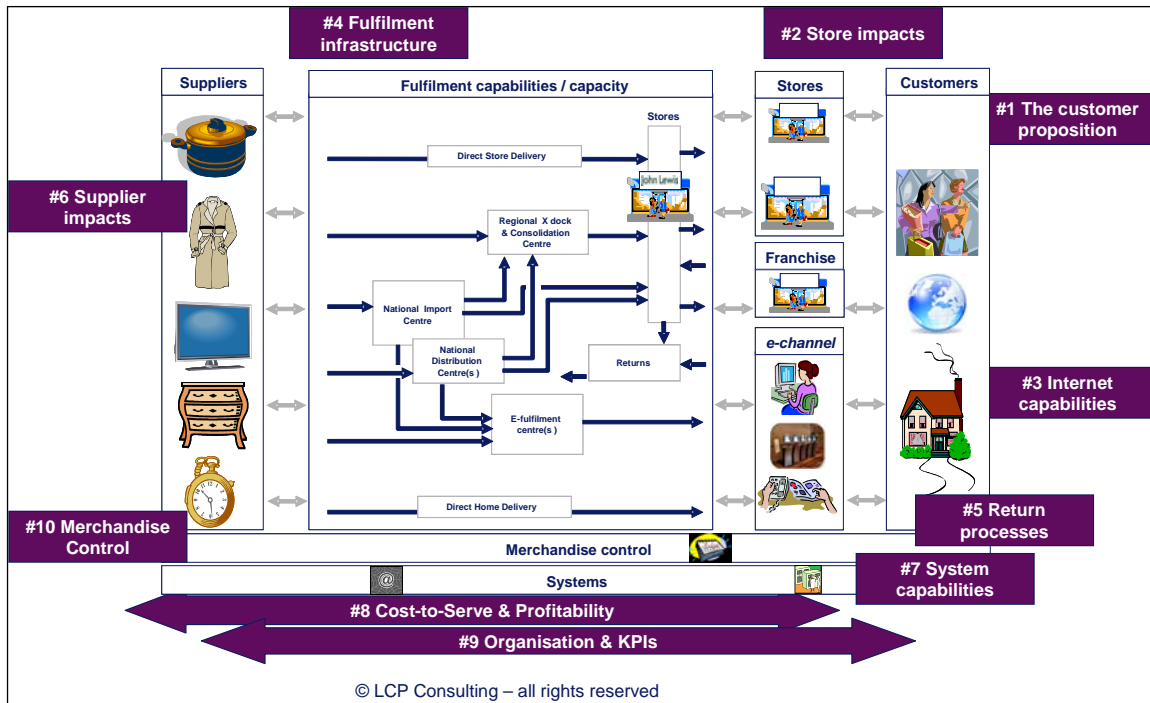
Online retailing is often classified into pureplay and multi-channel and the two operational models introduce different opportunities and constraints in their fulfillment design and execution. Our analysis points to some key factors that determine fulfillment architectures for internet retail; in the balance of this article we will introduce our framework for e-fulfillment (both pureplay and multi-channel) and explain its implications with a particular emphasis on extending the international footprint of e-retailing.

The schematic shows LCP's framework for effective e-retailing; it requires the integrated definition of how a business addresses ten challenges over eight operational zones from suppliers to customers. We observe that inconsistent or incomplete definition of the operating model is a barrier to profitable growth. Of course, fulfillment is central to the whole operation, to include stores impact, where applicable, and returns. Fulfillment drives the majority of the cost base and determines the ultimate customer experience.

In this article, it is not possible to deal with all the challenges in detail; our key focus will therefore be on fulfillment for international expansion.

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LCP's framework for effective e-retailing



Addressing the fulfillment challenges should always start with the customer proposition and the brand relationship with the shopper. The 'offer' (both product portfolio and services) should be consistent with what the brand stands for and meet customers' expectations. The mantra must be consistency in range, pricing, delivery and support. For example, Harrods or John Lewis have very different customer positioning and service ethics to Boots or Amazon. This in no way impugns those brands, but serves to emphasise that the customer will approach them with different expectations. The positioning of the offer and fulfillment service should guide the customer within the context of their aspirations and brand expectations towards capabilities that protect margin for the retailer.

Retailers with a high street presence have more of an opportunity to add value to the relationship through interactions such as click (or reserve) and collect, kiosks to extend the range, and returns management. For pureplay retailers, the pressure of price competition is even more intense and the potential moments of truth in the customer experience are fewer, more remote and harder to put right when it goes wrong. It is this constraint on customer intimacy that is restricting the depth and value of pureplay relationships with customers and driving the market to price competition, notwithstanding that some have overcome that barrier.

Marketeers, tasked with sustaining meteoric growth plans, are focusing on 'stretching their brands' through the range offered (categories and products) and the geographical markets accessed. Our research points to some surprising conclusions on the effectiveness of these measures.

First, the online sales yield per sku (stock keeping unit) varies from less than £/€1,000 up to £/€50,000 or more. There is no empirical evidence that adding skus drives sales faster than it drives complexity and cost; rather the reverse is the case. Range growth presents risk. In the context of the generally accepted strategic wisdom that the

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web enables the offer to be extended, the cost and market penetration implications for any company hurrying to add to its online offer should be carefully weighed up. Less may be more, if it is focused.

Second, the stretching of geography is applicable to some but not all operators. Multichannel retailers with a strong country niche and limited store coverage can really benefit within a market. They can also stretch their brand to meet demand from other countries. But European markets have significant differences in consumer preferences and buying behaviours which only a few brands such as Zara and H&M have transcended. Pureplay operators looking to new countries face a big challenge to build volume and adapt their persona to the culture of different countries – a combination of our challenges #1 and #3 in Figure 1.

Our observations point to scale economies and/or a viral brand as being the keys to a successful on-line fulfillment model. Scale is not just about order volumes and operational productivity but also about the yield per sku, the stock efficiency and the systems investments required.

On-line retailers seeking to expand their geographical offer must therefore chart a 'climb' for servicing their growth operationally which may contain a number of transitions in terms of how capacity is put in place.

'Base camp' for most is a single point of fulfillment for Europe which helps to keep stock in one place and reduces the risk of obsolescence. This is entirely possible for low weight products; electrical goods and furniture are obvious exceptions as those products carry high international logistics costs. The main initial investment at base camp is in the software for transactional and logistics compliance and at the point of order which needs to include terms for delivery costs across borders. Use of an outsourced fulfillment service can mitigate these costs through their previous investments and bring carrier costs that leverage their buying scale and relationships. Paradoxically, the UK is a good place to fulfill from as bulk freight rates back to Europe are low and the exchange rate is favourable to trade in Europe. Service lead times may extend by a day or two and companies should consider that choice as it enables them not to duplicate fixed costs. But there are no insurmountable operational barriers to international fulfillment from a single site operation.

The on-line operator has a key task to decide the range that it will offer and organising the stock and replenishment to the e-fulfillment operation. This is particularly challenging for multi-channel companies as the stock may be in stores, distribution centres, at the e-fulfillment site and at suppliers. There are some mission critical processes to define to head off possible points of failure.

Intermediate 'camps' will be a sequence of steps in the development of fulfillment capabilities. These will depend on the market expansion route taken and the success (volumes) encountered by each specific retailer. As scale and market depth increases, the big choices are the locations to be used (national vs regional), the use of outsourcing as against own operation, changes to the delivery service offered and the charges for it, and the operational and contractual configuration of the delivery operations. The key to making these choices is always thorough cost analysis, solid process definition, realistic forecasts and a determined effort to avoid unprofitable complexity.

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The 'summit' of international e-fulfillment is a network of country or region specific locations where the range and services may be tailored to the specifics of the local market. Clearly that requires substantial scale which will be more easily attained by multi-channel operators who can leverage their existing operational volume and stock.

What will internet fulfillment look like a decade onward? Based on the predictions of ten years ago, the most extreme forecasts in terms of volume will become reality. We predict that fulfillment services will be fuelled by that market growth, prices for extended fulfillment will decline in real terms and IT will support virtual stock in the network, enabling greater product choice and lower sales yield per sku. For the time being on-line operators should concentrate on getting the basics right every time and avoiding unprofitable complexity.

About LCP Consulting

LCP Consulting is a leading specialist in customer-driven supply chain management. With over 20 years' experience in the field, we identify where supply chains make major contributions to how businesses operate profitably and compete effectively. We support businesses review, re-design and implement changes to their end-to-end operations. Our fact-based diagnostics pin point exactly where & how to cut costs, enhance operational efficiency and invest for the future.

LCP Consulting is a member of the Green Logistics Consultants Group, which is an international collaborative network of supply chain consultants who focus on improving the environmental performance of supply chains.

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