FASHION IN FLUX:

MASTERING THE OMNI-CHANNEL SUPPLY CHAIN

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The fashion and retail industry is in a state of flux. Multi-channel selling through physical and online channels is now the norm even for the most traditional retail and fashion brands. However, multi-channel is rapidly morphing into omni-channel retail – and there is a big difference between the two. Particularly when it comes to the supply chain.

Multi-channel retail has been around for a long time. The term simply means selling through more than one channel – e.g. bricks-and-mortar stores, catalogue or online and kiosks. In most companies, each channel was managed separately, with its own demand forecasts, promotions and even price adjustments. Not only is multi-channel retailing expensive (multiple inventories, redundant supply chain assets, etc.), it no longer reflects how the shopper shops today.

Omni-channel retail is all about providing the consumer with the ability to shop and return goods via any channel, through any combination of on- and off-line interaction points. Omni-channel retail represents the convergence of all previously segregated selling channels into a single channel of orchestrated product flow designed to deliver not just products but the highly individualized shopping experience the customer has come to expect.

The shopper cares nothing for how the retailer solves its omni-channel buy-deliver-return shopping behaviors internally – e.g. what systems and processes are required to deliver the expected service. He or she simply assumes the retailer will perform to expectations.

This shift to an omni-channel approach means the traditional fashion supply chain must step up its game – to become fast, agile, responsive, accurate, optimized and innovative. Previously separate channels must now converge into a single channel that can deliver the goods,

and enable the sale and the return – with complete visibility and control at a sustainable cost structure.

No retailer or fashion brand has mastered these challenges of convergence yet. In fact, most are still in the early stages of this journey.

Exploring the state of play in omni-channel retailing is precisely the focus of this white paper. The paper is based on the 2014 Fashion MasterClass, an event organized by DHL with the focus of bringing together senior supply chain executives from a cross section of the fashion industry for a day of dialogue. Participants in the class came from global brands such as Adidas, Nike, Tom Tailor and WE Fashion.

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The MasterClass provided a forum in which to exchange ideas about the current and future state of omni-channel retailing – issues, challenges, new ideas and lessons learned. This paper is based on these discussions, as well as additional research conducted on behalf of DHL Supply Chain. It covers a range of fashion and lifestyle topics, including:
- Current state and driving trends
- Key supply chain challenges
- The fit-for-purpose omni-channel supply chain

It is clear from the comments of the MasterClass participants, as well as additional research, that no silver bullet exists to solve the challenges of omni-channel retailing. This paper, however, furthers the exploration of possible solutions for moving the dial toward a converged retail channel that satisfies customers and controls costs in a way that delivers profitable business.

Part 1: Current state and driving trends

The evolution from the multi- to omni-channel business model is the hottest topic in fashion retail today. This is far from easy, and there is no single 'right' approach. Rather, retailers are finding their way as they go, driven by their relentless taskmaster – the consumer.

Consumers continue to expand their buying activities to take full advantage of all the shopping options available to them today – online, mobile, in-store. They increasingly expect competitive prices and an 'endless aisle' of product, easy ordering, free delivery, and even free returns to their location of choice.[1]

Because of these behaviors, omni-channel shopper behavior has become highly complex – at least from the retailers' perspective. IDC Retail Insights uses the term "stop-start shopper" to describe omni-channel consumers. "Stop-start shoppers generally 'hop' among numerous channels and touch points over an undefined period of time prior to making a purchase," the research firm explains in a recent report.[2]

Regardless of their shopping mannerisms though, consumers increasingly want retailers to deliver a seamless experience; one that offers the same product selection, purchase and fulfillment options, and level of service regardless of how, where, when or why the consumer interacts with the retailer. "Shoppers don't merely prefer such seamlessness," notes retail research firm Kurt Salmon, "they expect it. Indeed, for many, the term omni-channel has already become synonymous with 'retail.'"[3]

[1] Brian J. Gibson and C. Clifford Defee, "The State of Retail Supply Chain: Essential Findings of the Fourth Annual Report," JDA, 2014, p. 17.
[2] Christine Bardwell, "Redefining the Shopper Experience With Omni-channel Retailing," IDC Retail Insights, 2013, p. 2.
[3] Kurt Salmon, "Don't Call it Omni-channel," www.kurtsalmon.com, 2014.

Fashion retailers are scrambling to give customers what they want by broadening their sell and return options. Retailers currently offer, or plan to offer, the following services to customers:[4]

- Buy online, ship from store
- Buy online, pick up in-store, also called 'click and collect'
- Buy via mobile or website in-store, ship to home
- Buy via mobile or website in-store, pick up in-store
- Site-to-store shipping (pick up in a store to which the inventory has been transferred from another facility)
- Buy online, return to store
- Buy in-store, return to another store
- Provide lockers for anytime order pickup

There is another shift in the works as well. Since 2007, RSR Research has benchmarked retailers' attitudes about the challenges and opportunities associated with

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harmonizing existing and emerging selling channels. In its latest study, RSR notes:[5]

"Although in the past several years we've seen that the profit value of a cross-channel shopper consistently exceeds that of the single channel shopper, that advantage is beginning to level off (Figure 1). Why? It's simply because for consumers, the ability to begin and end their shopping experience in the digital domain, or augment their store experience with digital mobile, is now taken as an expectation."[6]

[4] Alicia Fiorletta, "Aligning Inventory Strategies With Omni-channel Demands," www.retailtouchpoints.com, 2013, p. 2.
[5] Nikki Baird and Brian Kilcourse, "Omni-channel 2014: Double Trouble," Retail Systems Research, August 2014, p. 1.
[6] Ibid.

Figure 1: Multi versus single channel customers

Source: RSR Research, 2014.
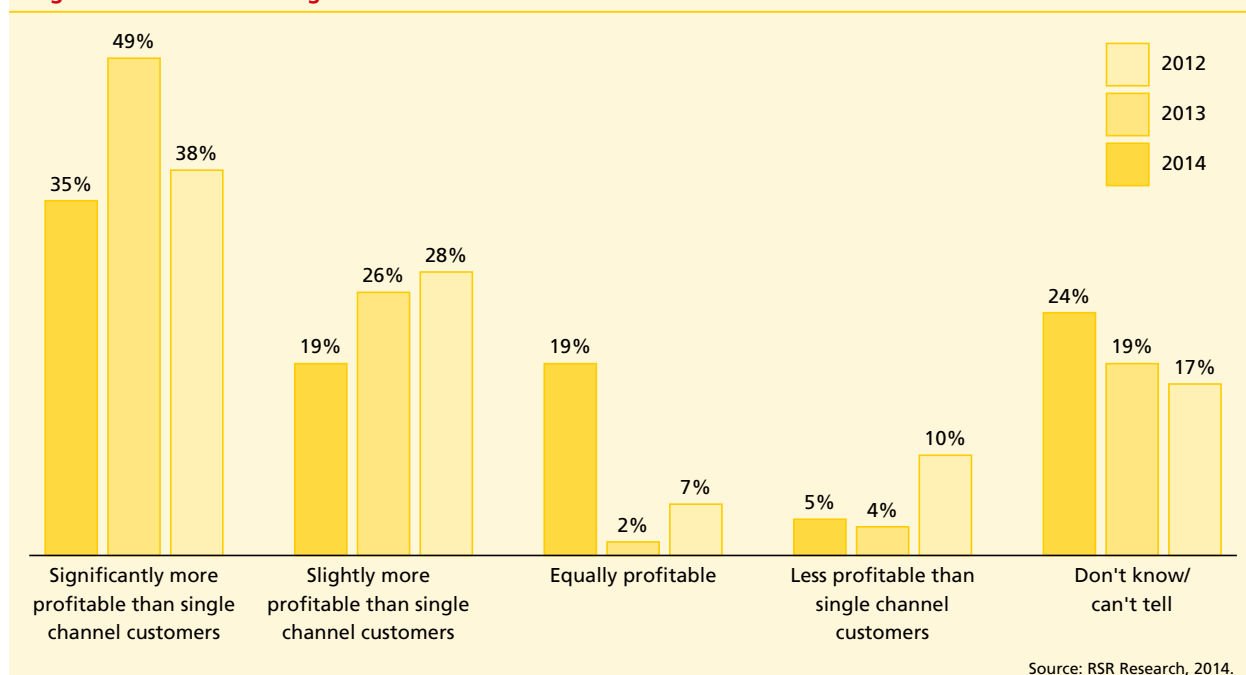
In other words, the stakes are changing as consumers increasingly take the ability of the retailer to provide a seamless, omni-channel experience as a given. For consumers, omni-channel is just shopping – period. Therefore, as the RSR chart indicates, "a retailer is only disadvantaged if it does not offer a seamless shopping experience that traverses the digital and physical domains."[7]

Despite this finding, few retailers can yet claim to offer a truly seamless experience – one that successfully spans all channels and meets buyer expectations. Providing such an experience requires that everything – from the retailer's IT infrastructure to the ways in which it incentivizes store sales associates – be expressly designed to support it.

Retailers, says Kurt Salmon, need to operationalize omni-channel, and they are not there yet.

"We are at an inflection point," concurs one senior supply chain executive at a global retailer. "Our processes are still slow. They have not caught up with our customers."

While operationalizing omni-channel ultimately requires changes to every functional area, certain areas need to change first, among them the physical supply chain and the information systems that support it. These two areas are the focus of Part 2 of this paper.

[7] Ibid.

Part 2: Key supply chain challenges

As formerly segregated channels converge to deliver what the customer wants, organizations must develop successful strategies for blending in-store operations with the traditional and e-fulfillment supply chains in a way that delivers profitability and performance. As well as blurring traditional channel boundaries, the information supply chain must evolve from multiple siloed systems to a single omni-channel architecture.

During the Fashion MasterClass discussions, participants wrestled with these issues. However, two key aspects of this physical convergence trend emerged as most concerning to the group:
- Integrating the store as a fulfillment center
- Managing converged inventory end-to-end

Integrating the store as a fulfillment center

Stores clearly remain a critical component of the global shopping experience – but their role is changing as the relentless march toward an omni-channel business model continues. "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," according to Nikki Baird and Brian Kilcourse of Retail Systems Research. "Stores, in fact, are becoming fulfillment centers."[8]

Technically, the benefits of sourcing inventory from stores appear numerous. "Stores can be used to increase

[8] Ibid, 4.

speed to the customer – an important factor in competing against mega-competitors such as Amazon. Ship-from-store can also be used as a relief valve to siphon orders from the fulfillment center during peak processing, reducing the capital investment required to meet the defined service-level agreement."[9]

Further, a recent report from Jones Lang LaSalle notes that e-commerce fulfillment centers are particularly expensive to build and operate – driving up the cost of building and expanding in-house e-commerce fulfillment operations. Thus, Kurt Salmon points out, store fulfillment offers the promise of leveraging existing infrastructure and labor to reduce the burden on a growing e-commerce business.

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A handful of early adopter retailers are actively executing ship-from-store programs, with some early successes. U.S. retailer Nordstrom, for example, saw its annual inventory turnover rise to 5.41 from a previous five-year high of 4.84. Another major department store saw a 20 percent increase in same-store sales growth that led to a $200 million improvement in gross margin, as well as a $200 million reduction in average inventory.[10]

Fulfilling from stores also becomes part of a broader markdown avoidance strategy – one that can improve margins. For example, U.S. retailers Ann Taylor and Danier Leather report margins increased one to two percent overall and up to 30 percent on items nearing

markdown. In fact, Ann Taylor's CEO notes that, by using ship-from-store, "We are able to liquidate product on markdown at a much higher gross margin rate."[11]

Markdown avoidance strategies are becoming such a margin driver that even the cost of shipping from stores furthest away is becoming seen as comparatively negligible, as Macy's CEO Terry Lundgren told an audience at a recent global retailing conference. "Avoiding a markdown is almost always a better choice," he commented. "It's well worth the shipping cost."

Among the most advanced global retailers, tapping the potential of the store in omni-channel retailing goes far beyond simply turning inventory faster or reducing markdowns. These companies view their stores as a powerful medium for delivering a brand 'experience' to the consumer that includes engaging the customer in a member-like community, providing sales associates who are expert in an area related to using the product (e.g. competition runners consulting on running shoe options

[9] Kurt Salmon, "The Core of Omni-channel Retailing," www.kurtsalmon.com, 2014, p. 4.
[10] Dave Lodwig, "Winning the Omni-channel Fulfillment Wars," W&H Systems, 2014, p. 2.
[11] Kurt Salmon, "The Core of Omni-channel Retailing," p. 3.

for the customer), and other experiential offerings. One global retailer at the Fashion MasterClass explained omni-channel and the role of the store in this manner:

"Omni-channel is an opportunity to become more consumer centric," he observed. "In the end, it always starts with the consumer. Seamless is important, but creating a single, integrated channel to the customer is the end goal. We are investing heavily in our retail stores to make the customer experience better. We want to grow from our customers being 'brand consumers' to highly engaged 'members' able to shop across all channels. Highly engaged 'member' cross-channel shoppers – the next step beyond plain omni-channel shoppers – carry a lifetime customer value that is three to four times greater than the average brand buyer."

Shifting the role of the store to one that includes using it as a fulfillment center, however, poses several significant challenges. The most concerning of these challenges relate to managing inventory – our next topic.
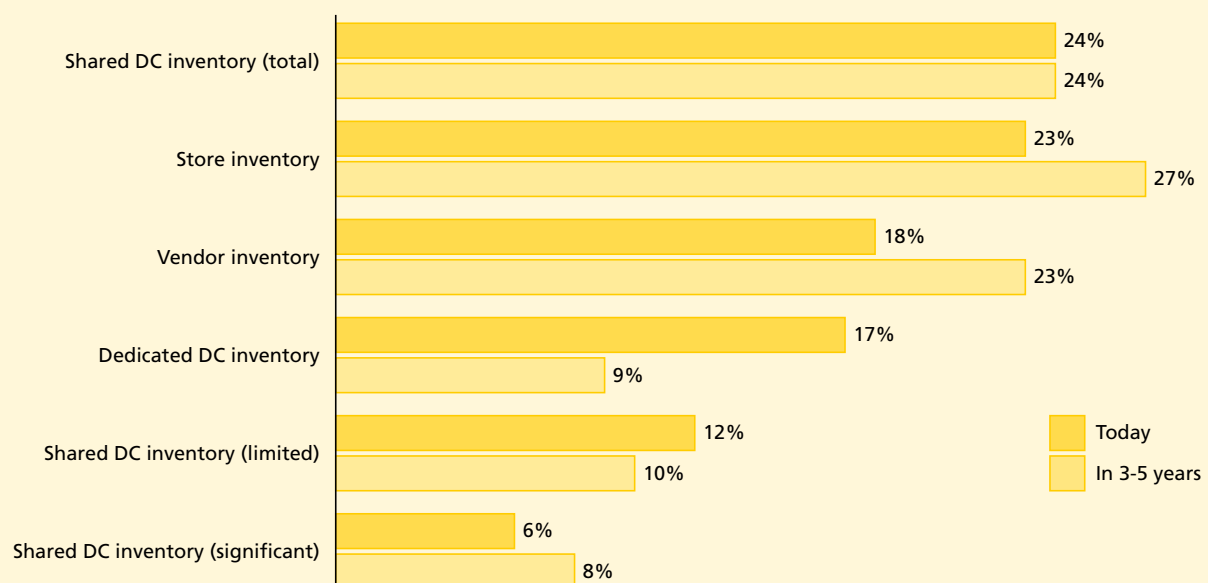
Managing converged inventory end-to-end

Effective inventory control is essential to the success of omni-channel retail. As consumers' buying options increase, dedicating inventory to specific channels and running separate supply chains to support that dedicated inventory has become an outmoded approach – it is simply too expensive. Leading retailers, therefore, are using shared, converged inventories to reduce enterprise-wide stock levels while maximizing availability across channels.

Less than 10 percent of respondents in a survey by software firm JDA indicated they expect to have dedicated inventories in three to five years. Instead, inventory sharing at the store and DC levels for online order fulfillment will become the norm.[12]

As Figure 2 shows, one of the biggest increases in shared inventory will come from the stores. Retailers will also expect vendors to hold more stock in the future.

[12] Gibson, Op. Cit., p. 10.

Figure 2: Inventory sharing strategies

	Today	In 3-5 years
Shared DC inventory (total)	24%	24%
Store inventory	23%	27%
Vendor inventory	18%	23%
Dedicated DC inventory	17%	9%
Shared DC inventory (limited)	12%	10%
Shared DC inventory (significant)	6%	8%

Source: JDA, 2014.

Utilizing stores as fulfillment centers for online and cross-store orders, however, poses new inventory management challenges for retailers. Because of regular movement and handling of merchandise within a store, store-level inventory accuracy commonly ranges between 50 and 80 percent, according to Kurt Salmon – a statistic echoed by the MasterClass attendees. Understandably, this poor in-store inventory accuracy creates significant problems for omni-channel fulfillment – problems that often translate directly into customer dissatisfaction.

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To address this in-store inventory accuracy challenge, apparel powerhouse Inditex SA plans to roll out RFID technology throughout its Zara store operations.

RFID technology "gives us great visibility, knowing exactly where each garment is located," says Inditex CEO Pablo Isla, in a recent Wall Street Journal article. "It really changes how we operate our stores."

RFID chips can store information about whatever item they are attached to and, when prompted, emit that data via radio signals to a scanner. Inditex is burying the chips inside its garments' plastic security tags, an innovation that allows the fast fashion chain to reuse them after the tags are removed at checkout.

By the end of this year, more than 1,000 of the 2,000 Zara stores will have the technology, with the rollout completed by 2016, Mr. Isla said.[13]

[13] Christopher Bjork, "Zara Builds Its Business Around RFID," Wall Street Journal, September 16, 2014.

The store inventory visibility and accuracy situation points up the broader importance of inventory visibility across the end-to-end retail supply chain. Retailers must be able to dynamically allocate and fill orders across the omni-channel enterprise. This means being able to tap any inventory within the end-to-end supply chain, whether it is sitting in a DC or store, moving between facilities, or in production at a supplier.

According to an RSR study of retail 'winners' and 'laggards,' enterprise-wide inventory visibility is a key differentiator in omni-channel execution. Approximately 63 percent of 'winners' said they have access to inventory across the entire enterprise, while only 25 percent of 'laggards' are in the same position. Poor visibility "prevents 'laggards' from fulfilling non-store customer orders from store inventory," the report revealed.[14]

Advances in inventory visibility, and using that visibility to manage inventory across channels, promises multiple benefits for shoppers as well as for retailers. For example, Macy's found that:[15]

- It allows store associates to rapidly check system-wide availability, locate an item and make it available for delivery or next day pickup by the shopper
- It can reduce markdown costs and inventory write-offs by enabling some mis-located items to be sold, either online or in alternate stores
- It can enable store inventory items to be available to fulfill online orders on the retailer website, even when fulfillment center inventories are depleted

Other companies are adopting technology platforms that enable them to sell goods in transit – e.g. while still on the ocean. This capability is made possible with visibility platforms that provide real-time information on inventory anywhere in the supply chain.

[14] Fiorletta, Op. Cit., p. 3.
[15] James Tenser, "Omni-Channel at Macy's: It's About Inventory Too," www.retailwire.com, 2013, p. 1.

Part 3: The fit-for-purpose omni-channel supply chain

To be successful and profitable in omni-channel retailing, retailers still need a supply chain that is fit for purpose to handle product forward and reverse flows as effectively and efficiently as possible. To do this, retailers need their supply chains to provide certain core execution capabilities:[16]

- A flexible physical fulfillment network designed to support the various fulfillment requirements
- Real-time visibility into the entire pool of inventory to reduce safety stock and inventory carrying costs
- Dynamic control over access and allocation of inventory in real time
- Processing and shipping of individual orders at the lowest cost, regardless of source (store/DC)
- Flexible fulfillment paths to meet demand, regardless of which channel it comes from
- Maximized efficiency in every part of the supply chain to meet customer expectations

[16] Lodwig, Op. Cit., p. 2.

Many retailers are outsourcing some or all of their requirements to global third party logistics service providers (3PLs).

- An effective, cost-controlled returns process
- Minimum cost to serve

Given the burgeoning cost to develop in-house capabilities– facilities, delivery systems, IT architecture – many retailers are outsourcing some or all of their requirements to global third party logistics service providers (3PLs).

Adding to the capabilities listed above, there are other key requirements retailers must get right to succeed in omni-channel commerce...

Align the organization to provide a seamless experience. The seamless customer experience starts with how fashion retailers align their organization and supply chains to serve the omni-channel shopper. "Many companies still have separate online and offline organizations," Raul Martinez, DPDHL In-house Consulting noted at the Fashion MasterClass. "That needs to change. Companies need to have the infrastructure to leverage 'cross-channel' – to deliver and return from everywhere."

Segment the supply chain as needed. "Not every product has the same characteristics from a number of perspectives: handling, value, volume, seasonality, service requirements, margin and so on," noted Marcel Beelen, Vice President, Global Business Development Fashion & Lifestyle at DHL Supply Chain. "However, many retailers ignore these differences and operate their supply chains as if all products were alike. An effective supply chain segmentation strategy tailors the supply chain portfolio to optimize support for products based on commonalities. Thus, fast-moving products could move through a DC bypass solution; slow-moving items could be stocked in a central DC; a store-to-store stock transfer solution could support demand variability for high-margin items."

Stay close to your core business. "Not every retailer needs to try to be an Amazon," notes Beelen. "If you are a fashion discounter, for instance, stick to what you're good at. Don't try to be all things to all customers."

Choose the right fulfillment and returns model, and manage costs aggressively. Customer preferences for buying and returning merchandise vary tremendously by segment, geography, available infrastructure and other parameters. "Home delivery is up to four times more expensive than a 'click-and-collect' store fulfillment option," Martinez reports. However, while click and collect is popular in the UK, for example, it is not in Italy. The omni-channel supply chain, therefore, must recognize that one-size-fits-all solutions will not work. At the same time, companies must apply the same cost-control rigor to managing the end-to-end omni-channel supply chain as they have traditionally applied to their established single channel (e.g. bricks and mortar).

ADDRESSING PHYSICAL FULFILLMENT ISSUES IN THE STORE

Most retail stores are not set up to fulfill orders. Backroom space is limited and devoted to merchandise and store supplies. Store employees are not warehouse workers, either. Their job is to sell product, not fill boxes. In addition, employee compensation is an issue, because sales commissions and compensation structures are not set up to account for store-fulfilled e-commerce orders.

Some stores assign an employee to be in charge of e-commerce order fulfillment – to make sure the orders get out the door – and adjust store compensation structures accordingly.

Another option, though, would be to outsource this fulfillment activity to a third party logistics firm as part of a total store services solution. "For one large UK retailer," notes Todd Starbuck, Chief Customer Officer, DHL Supply Chain, "we are already in their stores at night, replenishing shelf stock, getting goods on hangers ready for sale. Fulfillment is our business. Whether we are doing that in the backroom of the store and selecting the transportation service to optimize the cost, or we're doing it out of a warehouse, it's the same process, the same shipping material, the same optimization."

CROSS-BORDER REGULATIONS: A CONSTRAINT TO FUTURE GROWTH

As omni-channel retail expands across the world, cross-border regulations (customs and other) pose a potential significant constraint to growth.

"The challenge of customs clearance procedures for delivery and returns of e-commerce merchandise is particularly significant," reports Starbuck,. "We all thought customs would be a lot simpler by 2015. Judging by the look of it, that is not the case."

Customs complexities make it very difficult for e-commerce companies to explore growth in other countries. This is especially true with returns, where the cost of getting product back often exceeds the cost of delivering it.

One solution to this problem lies in using a third party logistics firm (3PL) to set up a bundled returns center in the country of delivery. "We can do a first- or second-level screening, thus allowing the customer to know what they've got before it leaves the country," explains Starbuck. "Together, we can decide what to do with the returned product – distribute it locally, scrap it, or sell it to a wholesaler."

Another option involves tapping 3PL software solutions that provide fully landed delivery cost in the customer's preferred currency, with all duties, taxes and shipping costs included. As Starbuck explains, "This helps our customers understand the impact of their cross-border delivery choices – and how different choices can have a dramatic cost impact."

Conclusion: Prospering in flux

The fashion industry is no stranger to change, but the evolution of omni-channel operations is clearly upping the ante. The expectations of fickle, demanding shoppers are increasing, and brands are responding with new fulfillment options in an effort to bolster customer service. The 'always-on' seamless shopping experience is compressing turnaround and fulfillment time; an issue that is forcing apparel companies to rethink their fulfillment strategies.[17]

BCG Partners indicates that a successful omni-channel fashion supply chain must incorporate:
- Accurate and real-time end-to-end inventory
- Lean warehouse operations for e-commerce orders
- Adapted store operations for omni-channel product flows
- Optimized downstream delivery
- Efficient and leveraged return flows

These five components are supported by total channel flow optimization and IT systems designed to handle the complexities of an integrated omni-channel operating model.

Summing up, from the MasterClass discussions and global research studies, it seems clear that three key factors will differentiate leaders from laggards in omni-channel retail.[18] First, retailers will need exceptional competency in technology – almost to the point of being a technology company first and a retailer second. Secondly, successful retailers must innovate and explore new ways in which to organize and operationalize for omni-channel retailing. Success in omni-channel retail is not about 'playing it safe' by making incremental operational improvements.

Finally, supply chain and logistics will be a key differentiator. Getting the supply chain right – from inventory management, to delivery, to returns – will not only satisfy customers but also drive profitability and advantage for the future.

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[17] Edgell Communications, Inc., and Apparel, "Re-Examining Omni-channel with Next Generation Demand Chain Management," 2014, p. 6.
[18] Lodwig, Op. Cit., p. 4.

About this paper

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