Reimagining Retail

Modernizing Supply Chains to Meet Changing Consumer Demands

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Online sales rose 19% worldwide in 2020 and continue climbing today. More than 75% of Americans tried a new shopping behavior during the pandemic with most going digital.

Research indicates that COVID-19 accelerated e-commerce adoption by nearly 10 years. For a nation with more square feet of retail space per person than any other country in the world, the pandemic served as a reckoning for physical retail spaces that it was time to modernize or move on.

The pandemic did not close the door on physical retail, as some predicted. In fact, it sparked a reimagination for how outlets can stay relevant: by offering a multi-channel shopping experience. Meeting changing consumer demands by rethinking their role in the supply chain is far from a death knell for physical retailers – **it's the start of a renaissance.**

Retail's Changing Landscape

The pandemic is just the latest in a series of pressures placed on retailers. With lower margins than most sectors, cost concerns top the list. Evolving consumer demands for faster, cheaper and better service complicate matters even more. **Overall, the pressure points are concentrated in five areas:**

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1

The Acceleration of E-Commerce

E-commerce sales have been increasing by double-digits for years, including a more than 14% jump from 2020 to 2021, bringing the annual sales total to nearly $900 billion. Yet despite such an impressive number, e-commerce only accounts for slightly more than 13% of total U.S. retail sales. In fact, e-commerce lost ground to brick-and-mortar in 2021. That has retailers in a tough spot. They must rapidly invest in e-commerce fulfillment while also maintaining a distribution network for the nearly 80% of sales coming out of physical locations.

2

The Consumer's Need for Speed

Order fulfillment is a growing challenge because of delivery norms created by giant online retailers. The biggest culprit: same-day and next-day shipping. Shoppers selected same-day or next-day options nearly 60% of the time with store-based retailers in 2021. Less than a quarter of shoppers will wait for day three. Now retailers of all sizes must figure out ways to meet two-day delivery demands among already strained equipment, processes and personnel – or risk losing business to the companies that can.

3

Returns and Reverse Logistics

At a physical store, consumers can see, feel, fit or use a product before buying. Not so with most e-commerce sites. According to the National Retail Federation, nearly 21% of everything sold online gets returned. In fact, people often buy multiple products in different sizes or colors with the intent of making a return. That erodes profitability. A returned product can take weeks to return to inventory, but, just as frequently, it ends up liquidated or in a landfill. This generates high shipping, handling and processing costs. Returns also tie up capital and space in unwanted inventory.

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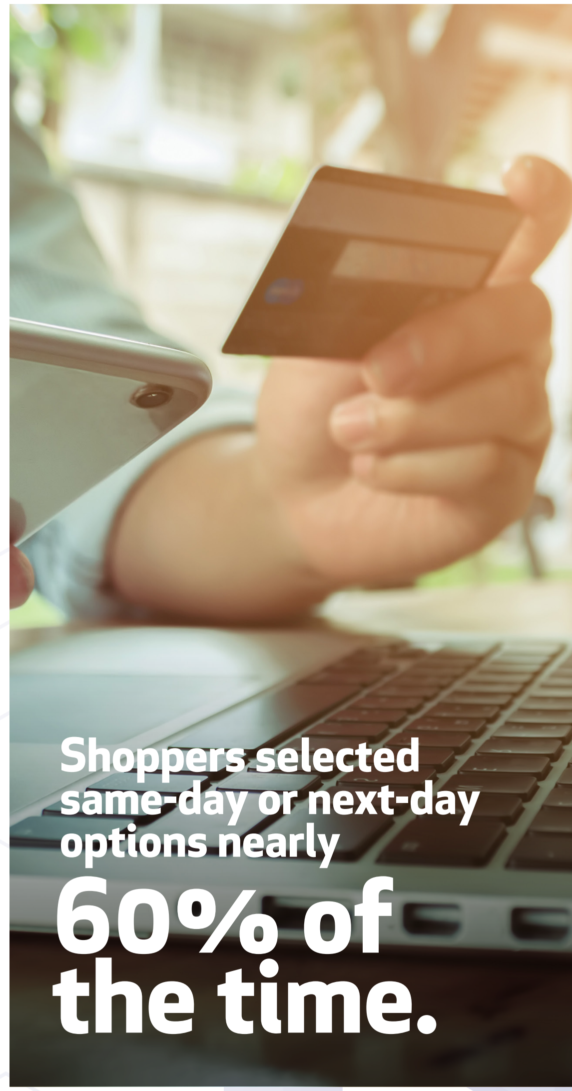
The returns process represents an important touchpoint between retailers and their consumers. Failure to manage it well costs companies future business. As a result, retailers are investing heavily in improvements to the online shopping experience, while also working to increase store foot traffic, as a strategy for improving purchase confidence and minimizing returns.



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Managing the Last Mile

The rise in e-commerce has retailers wrestling with last-mile deliveries. As a share of total shipping expenses, the last mile accounts for 53%. The major problem is inefficiency. Retailers can streamline large volume shipments inbound to distribution centers and stores. Outbound last-mile shipments require multiple stops with low drop sizes covering both rural and urban areas. Finding fuel-efficient routes is extremely difficult. Last mile also takes comparatively more drive, idle and labor time. A rise in digital sales, paired with the growing norm of "fast, free shipping" has retailers scrambling to drive down last-mile costs without compromising on customer service.

5

Issues with Inventory

Supply chain delays have retailers searching for inventory innovations. Shipments from China to the U.S. West Coast now average more than 100 days compared to less than 50 in 2019. The delays have tied up billions in inventory. Most Americans have experienced the longer lead times for online orders and empty store shelves. In response, some retailers are resorting to less SKUs to improve their in-stock levels. Others are moving to zero-inventory stores, essentially turning their sales floors into showrooms. Shoppers can view and test products, but do not walk out with them. Instead, stores ship the products later, buying time in the supply chain while minimizing carrying costs. Stores like Best Buy and Bonobos pioneered the model with other retailers now coming on board.

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The Future of Physical Retail

In the last three years, companies closed nearly 25,000 U.S. storefronts. For perspective, that is the equivalent of 16 deserted Mall of Americas. But as they say, necessity is the mother of invention. **Now everyone – from property owners to consumers – is getting creative when it comes to what retail shopping looks like**.

Half of all consumers still shop in stores on a daily or weekly basis.

Refilling Retail Spaces

Property managers and owners are rethinking who belongs inside their retail centers. With a more diverse tenant profile, they can transition the traditional mall into a one-stop-shop for consumer needs. Storefronts previously lined only with apparel and home goods, increasingly now include doctors' offices, grocery stores, restaurants, day cares, pharmacies and more. The move makes for a transformed shopping experience and increases foot traffic to benefit every tenant inside.

Other property owners are changing their financial model to accommodate the new realities of retail. Rather than burdening struggling physical retailers with fixed-sum rents, they are moving to a percent of sales structure. This creates more of a partnership and incentivizes the owner to create a mall mix that drives sales.

Direct-to-Consumer Storefronts

Analysts and investors have long seen direct-to-consumer (DTC) brands as having an insurmountable financial advantage over physical retailers. Now even that is changing. The DTC space is overly crowded because of ease of entry. The intense competition has customer acquisition and marketing costs skyrocketing. Looking for a new advantage, DTC retailers now are opening physical stores or partnering with brands that already have them.

According to a December 2021 report by PwC, half of consumers still shop in stores daily or weekly. Physical stores serve dual purposes as both a marketing tool for brand building and a place where consumers can browse and buy. Those locations also help drive sales, including online purchases. Coresight Research reports that closing a brick-and-mortar store decreases total market sales for a retailer by as much as 50%.

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Whereas online buying is about convenience, in-store shopping builds brands. Consumers want to test a product, ask questions in real time and compare options easily. Physical locations simplify each of these consumer requirements. Now companies historically selling online only – like Warby Parker, Glossier and Wayfair – have physical storefronts. Other companies like Casper and Allbirds are partnering with existing big box retailers to leverage their physical locations. Target is benefitting by giving counter space to smaller online beauty brands to take a bigger bite of the more than $500 billion beauty industry. Even bankrupt brands vowing to reemerge online only like Nieman Marcus and Toys 'R Us are returning to physical stores.

While every location for retailers may not be cash-flow positive, they serve a higher purpose in driving overall sales, meeting customer expectations and building the brand. Rather than retailers considering e-commerce versus brick-and-mortar, they perform better when using a strategy relying on both.

A New Way to Shop: How Retail Outlets Can Adapt

Reinventing the supply chain for mall stores relies on companies getting localized logistics right. Success comes down to how retailers plan, view, store and distribute their inventory. **The time has come for managing what people buy – and how they buy it – differently.**

Most stores that ship from mall locations save an average of 5-10% annually on final-mile costs.

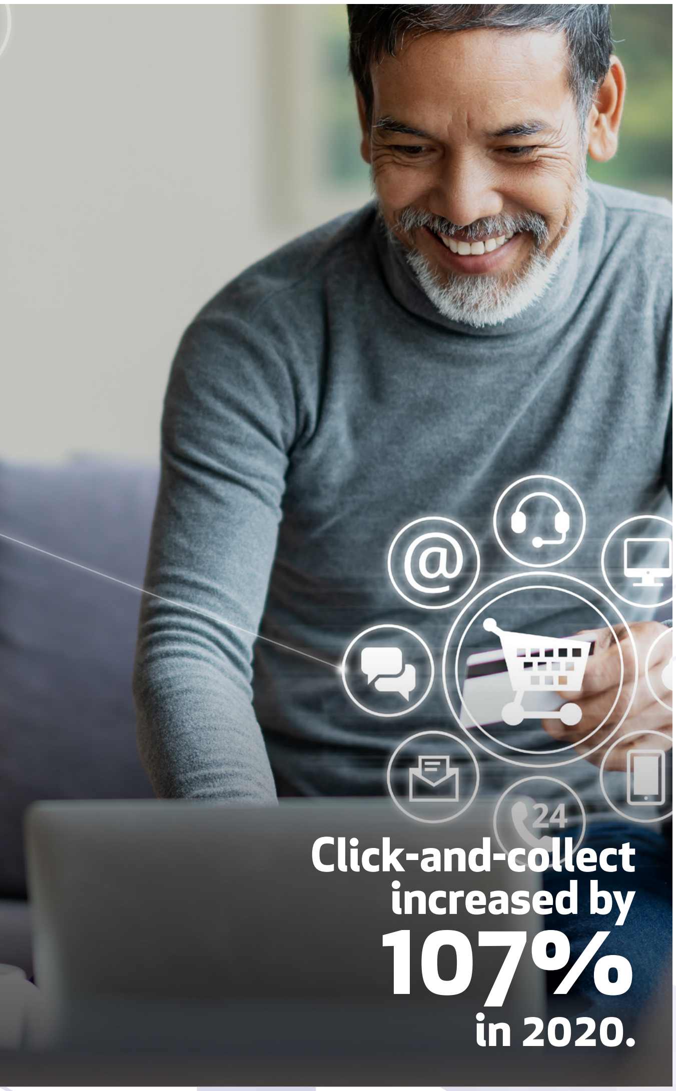
The Downside of Distribution Centers

Today's traditional retail logistics model relies heavily on distribution centers (DCs). The philosophy behind these warehouses is creating large inventory hubs located near population centers. The idea works, but not as well as it once did as shopping behaviors change.

First, distribution centers are expensive to stand up. They generally take several years and millions of dollars to build. Their permanency makes responding to new retail realities difficult. For example, strategically located urban DCs struggled with evolving shipment networks as people migrated to the suburbs during the pandemic.

Second, distribution centers tend to tie up unnecessary money in inventory. There is a high risk of misallocation in having inventory at inconvenient locations for buyers. Managing hundreds of thousands of square feet in inventory requires significant labor and lends itself to inaccurate SKU visibility. DCs require higher minimum stocks. With consumer tastes constantly changing, that often leaves DCs with large inventory surpluses of outdated products taking up valuable space. Plus, most DCs cannot manage reverse logistics. They are ill-equipped to receive individual items and return them to inventory. Therefore, many retailers simply collect returns in trailers and eventually liquidate the shipments tying up cash and equipment for weeks or even months.

Third, shipping from DCs takes time and slows down the supply chain. There is no click-and-collect option. Over time, consumers will compress the two-day shipping clock even more. That means retailers must constantly stand up new DCs to get closer to the customer or increase shipping capacity exponentially. Neither are realistic options.



Opening Up Omnichannel Opportunities

According to *Harvard Business Review*, 73% of consumers use multiple channels during their buying journey. That means a visit online can easily result in an in-store purchase or vice versa. Customers also want options in how they receive their purchases. That includes home delivery, ship from store, and click-and-collect models like curbside pickup and buy online, pick up in store (BOPIS). Therefore, managing every consumer channel is more important than ever.

With the emergence of e-commerce, retailers initially responded by adopting a multichannel fulfillment approach. This model siloes sales into channels with a separate inventory for each. Inventory allocations are specific by distribution method keeping e-commerce and physical retail separate. This is a costly way to manage products in today's multifaceted retail environment.

Now retailers are moving to omnichannel fulfillment. This offers a unified inventory management and order processing model. One inventory supplies all sales channels including the needs of store locations. The approach creates more flexibility in the distribution network, minimizes inventory overages and serves customers' diverse shopping preferences.

The model relies on integrated technology from store to supplier giving a real-time view of orders and inventory. Order and distribution management, point-of-sale systems and customer tracking platforms work together creating a seamless experience both internally and externally. That visibility creates value in allowing retailers to ship to anyone from anywhere in their network. The playing field between e-commerce and physical retail becomes level, making both equally important to a company's top and bottom line.

With the omnichannel approach, mall-based retail locations can become huge assets in the supply chain by leveraging stores close to consumers as fulfillment centers.

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Using stores for fulfillment pairs the speed and ease of e-commerce with the talk-and-touch aspects of physical locations. Click-and-collect increased by 107% in 2020. Analysts expect another 21% in 2022 and 20% in 2023 resulting in well above $100 billion. Stores also are shipping direct to consumers foregoing the lag of distribution centers.

Underutilized space in malls is cheaper and quicker than standing up centralized DCs. Plus, malls already have the advantage of being close to the consumer to reduce transportation costs and to speed up deliveries. Coresight Research shows that most stores that ship from mall locations save an average of 5-10% annually on final-mile costs. Functions like click-and-collect eliminate final-mile costs altogether and support another consumer demand: environmental sustainability.

Fulfilling online orders through mall-based locations increases store turn rates and supports reverse logistics. Malls offer economies of scale by allowing retailers to work together with shared shipping, collection and return locations inside the facility. Leveraging the existing physical footprint of malls or other retail centers also reverses the trend of relying on new and existing distribution centers, which generates environmental benefits. For instance, by allowing online purchases to be returned in-store, less packaging material is used and sent to landfills, and carbon emissions are lowered by as much as 40% according to recent studies. Additionally, using existing retail space also helps create faster delivery options and lower shipping costs, increasing customer satisfaction – the ultimate driver of future sales.

Today, less than 10% of surveyed mall-based retailers use their stores for online order fulfillment. But as companies realize the distinct benefits of physical locations, that number is growing. Nearly 50% of retailers have budgets for partnering with tech-enabled logistics service providers to make the most of their mall-based locations. With their help, and a new way of thinking, mall owners, retail tenants and digitally native brands can thrive going forward.

Carbon emissions are lowered by as much as 40% when online purchases are returned in-store.

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About Fillogic

Fillogic is an experienced team of retail and logistics professionals, technologists, serial entrepreneurs and creative problem solvers with more than 160 years of combined experience. We are driven by a mission to help our partners decipher the writing on the wall as technology continues to rapidly transform the retail landscape.

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