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Business Insights: Retail Must Adapt Supply Chains if They are to Survive

Long before COVID-19, retailers, particularly those in consumer discretionary spending categories were already struggling. Increasing penetration of the internet connectivity and power of the mobile ensured a continued wave of consumers flocking to online.

With the continued second and potentially third wave of COVID-19, the retail sector is facing one of the most challenging times in recent memory. For discretionary retailers, the headwinds are especially strong given considerable uncertainty driven by competitive dynamics, concerns over consumer confidence, and heightened demand for last-mile delivery.

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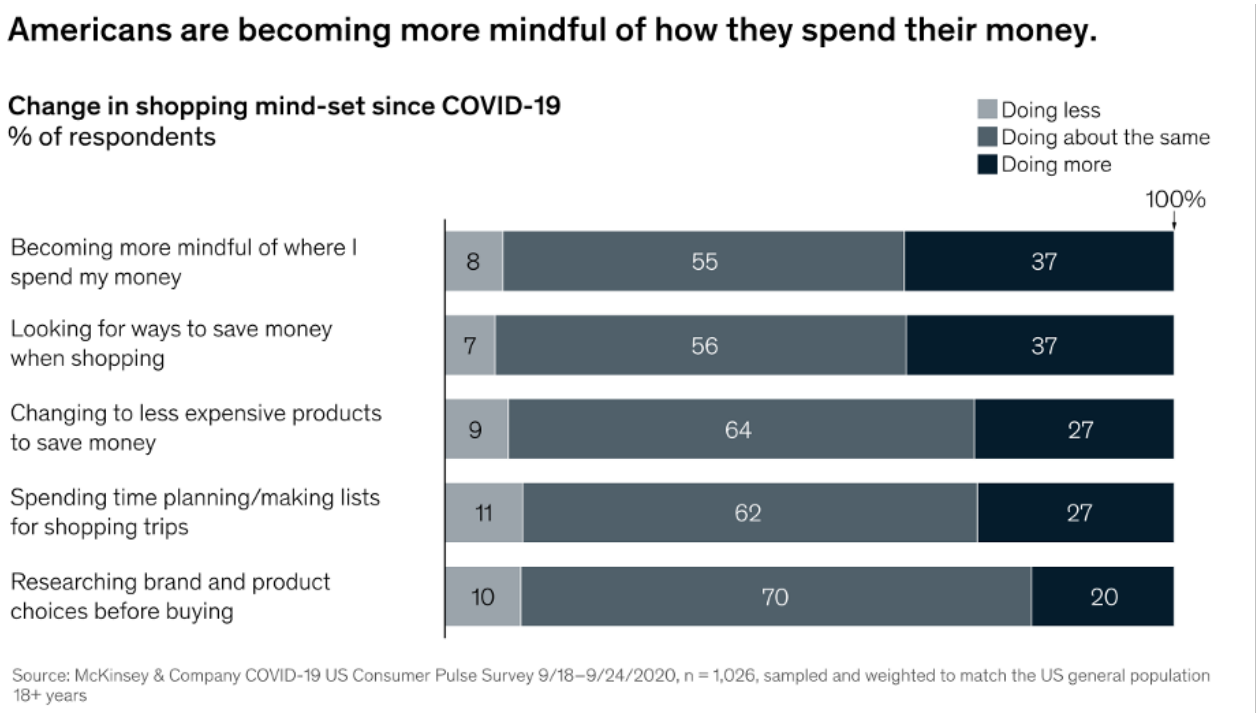
What is becoming increasingly clear is that COVID-19 has materially shifted consumer behaviour, leading retailers scrambling to adapt their supply chains to compete in the next normal.

Better supply chain management and consumer facing business technology will quickly become critical to their recovery path.

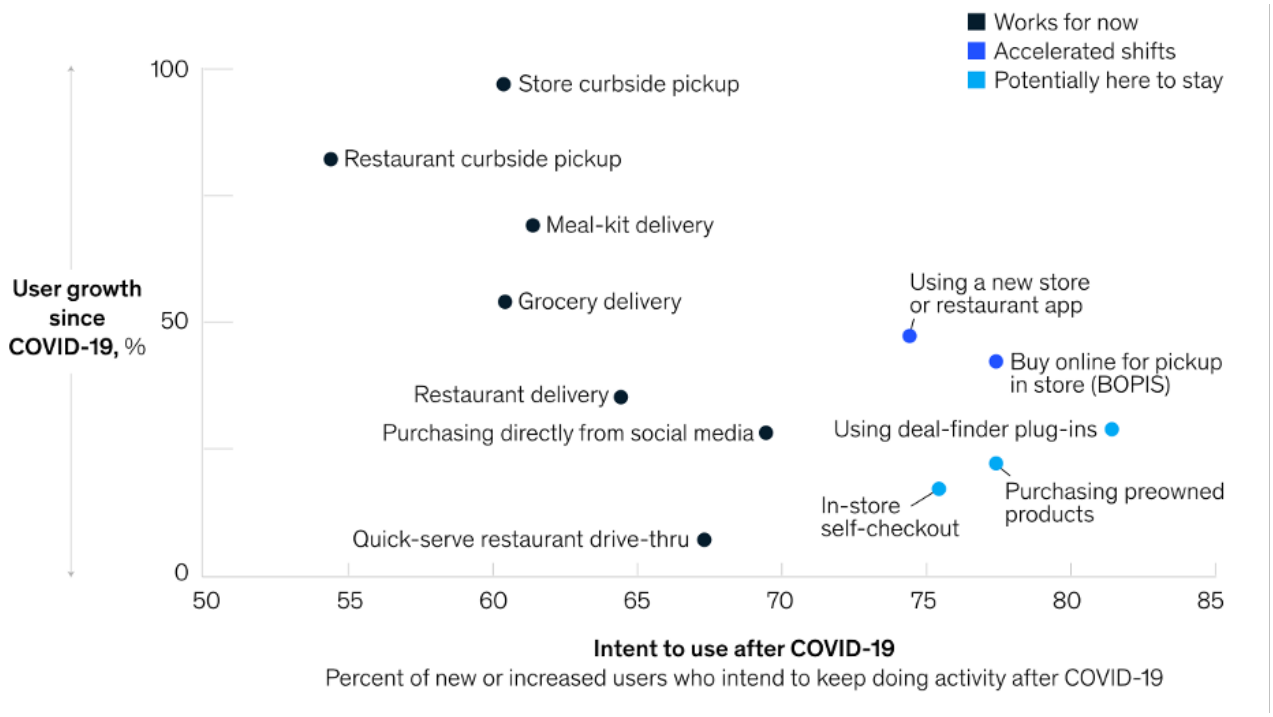
Major shifts in consumer behaviour

McKinsey in a recent consumer sentiment survey (September 2020) showed that greater than half of all US consumers expect that the personal and financial impact from COVID-19 will last more than an additional four months than first thought, and that decisions as to what consumers spent and where would become more of a focus.

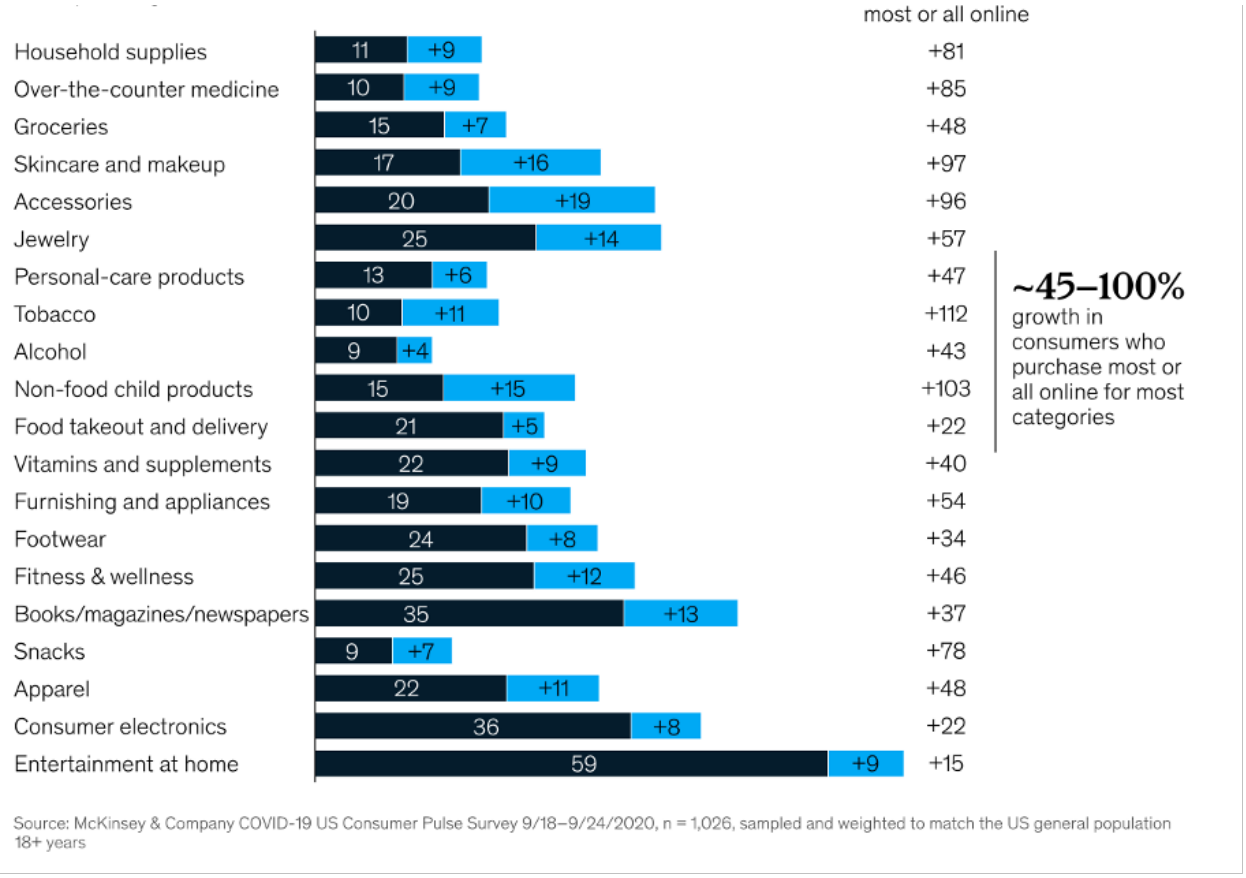
Overwhelmingly, consumers indicated they would be looking for more ways to save money when shopping and taking steps to be more disciplined in their choices.



The McKinsey survey also shows that consumer use of the online channel has increased for discretionary product categories. Consumers report that they expect to reduce many high-traffic, in-person activities in the future, including going to the mall. Given the social-distancing norms, consumers en-masse embraced digitally enabled omnichannel fulfillment. For example, store curb side pickup has almost doubled compared to pre-coronavirus levels, while “buy online, pickup in-store” (BOPIS) has grown by almost 50 percent.



Online shopping of non-discretionary items—through both conventional e-commerce channels, as well as new shopping channels with omnichannel fulfillment is poised to continue to grow post-COVID-19, particularly as consumers become more comfortable about buying without trying products first in physical stores. More than 30% or more of consumers say that they now make most or all of their purchases online for categories such as footwear, apparel, and home furnishings and appliances.



Source: McKinsey & Company COVID-19 US Consumer Pulse Survey 9/18–9/24/2020, n = 1,026, sampled and weighted to match the US general population 18+ years

Impact to the supply-chain

Online is not new, nor is changing consumer behaviours. The move from bricks and mortar has been taking place for some time and retailers have long been planning for changes in consumers' expectations and online behaviour, but they've generally assumed these changes would occur over a fairly long period of time.

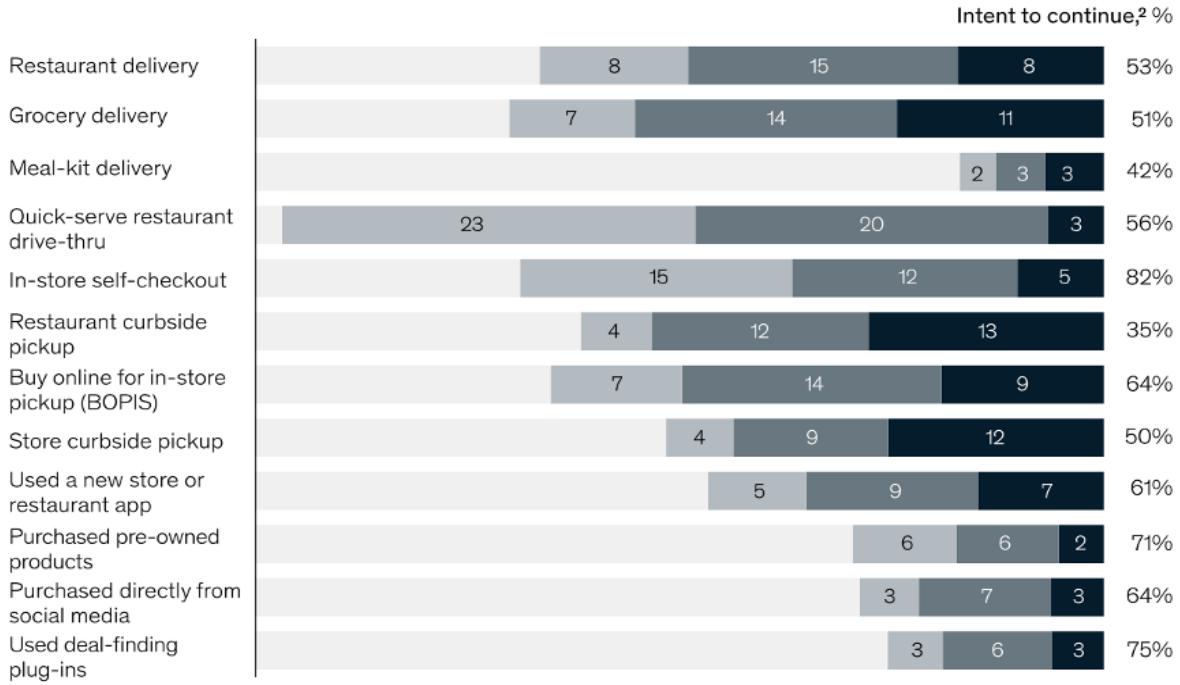
COVID-19 changed that and accelerated these almost overnight, with most retail supply chains unprepared for such an immediate impact and with lockdowns in many parts of the world, many retailers were simply unable to respond.

Shining a spotlight on the future, retailers will need to carefully manage consumers' expectation of seamless omnichannel fulfillment, whilst transforming their supply chains to increase their own productivity pressures.

Robust omnichannel offerings a must

Mandated social distancing and stay-at-home orders has finally woken up retailers, large and small of the need to accelerate omnichannel initiatives. Since COVID-19 lockdowns, most grocers and established players such as electronics sellers, department stores, and sporting-goods specialists, have accelerated the rollout of curb side pickup and home delivery. Even the smallest of owner enterprises, family restaurants and stores have found creative ways to offer contactless, click and collect and omnichannel fulfilment. Moreover, increased consumer willingness to purchase online (and to switch brands) is expected to intensify competition from single-brand, online-only retailers, which already have built e-commerce supply chains.

Use of digital and low-contact channels has grown markedly



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Omnichannel capabilities become essential

Omnichannel capabilities are essential for retailers to not only compete but ultimately to survive. Retailers must be able to differentiate their customers' experience in various ways including the speed of delivery (such as same-day or next-day); offering a wider assortment of products and brands and enabling end-to-end visibility (such as giving a real-time view of inventory in the nearest store, as well as real-time orders and returns tracking). Critical will be offering as standard a better experience with seamless orders, easy returns, personalisation and subscription services.

Productivity pressures

It's no surprise that productivity pressures are being felt by retailers, as many have responded to rising e-commerce demand by choosing to try and get more out of their legacy infrastructure and systems. But for most more expensive than traditional brick-and-mortar logistics because more inventory must be held in the network—creating a barrier to the faster and more predictable service levels that consumers now expect.

To address the combined challenges of fulfillment cost, service requirements, and productivity improvement, retailers have sought to keep inventories closer to consumption centres. In many cases, this practice has led to higher total inventory in the network. As example, McKinsey found that the inventory-turnover ratio at most US department stores has decreased over the past five years.

With strategies to address this and countermeasures put in place there is a risk that as e-commerce sales increase (as a percentage of total sales), this trend may intensify—leading to higher capital requirements and increased markdowns if retailers are driven to sell off extra inventory at the end of the season.

Supply-chain opportunities

Retailers who use this moment to think bold and beyond their present normal will win. Taking a clean sheet view of their supply chains is a necessity and by making sizable strategic investments to reshape the supply chain's role in value creation will enable them to thrive over the long term. According to research from McKinsey, "Creative problem solving that accepts constraints on capital availability as a given can help narrow the focus on finding flexible alternatives—and not just survive, but win".

Each supply chain node is important

By taking a critical look at the role of each node in their supply-chain network, retailers can start leveraging their store footprints for omnichannel fulfillment. Moving towards state-of-the-art micro-fulfillment centres in metro areas, and converting portions of their stores as mini, in-region distribution centres (DCs) will support faster delivery promise and faster fulfillment. All nodes in the network, including stores, distribution centers, deconsolidation centers, returns-processing centers, pop-up shops, and urban lockers, can be reassessed for their role. It's important that this comprehensive, rapid supply-

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chain analysis consider not only new demand profiles for the nodes owned by the retailer, but also how best to work with potential partners (such as local couriers and on-demand delivery players) to improve supply-chain performance.

Rethinking the role of all distribution nodes will likely prove essential in creating a sustainable omnichannel fulfillment model. For example, while most retailers have carried less inventory in their DCs by pushing product to stores, the result can be higher markdowns and unsold inventory. To solve this, some retailers are starting to use their port warehouses as temporary stocking points for imported products. These port warehouses could assume a greater role in pooling inventory upstream, so that retailers can push inventory to stores opportunistically rather in quantities too large for the stores' demand to absorb. A few retailers have considered repurposing stores to serve as fulfillment nodes for fast-moving products.

Collaboration even with competitors must be looked at

Survival and growth could depend in part on carefully considering which activities should be done in-house rather than outsourced. Historically, discretionary retailers have been shy of outsourcing logistics, fearing they might lose their ability to beat competitors to market. But the purported advantage was rarely worth the cost—and now the cost is simply too great. New technologies and business models mean that retailers can have more visibility (and even control) over outsourced logistics overcoming a perceived barrier.

With the need to preserve cash, retailers could explore partnerships with each other—or with third-party logistics (3PL) companies, real estate or warehouse providers, or fourth-party logistics providers that take over management of even more of the supply chain. For example, noncompeting retailers could enter into a consortium-like partnership to use each other's distribution nodes, or a common 3PL provider to achieve wider geographical reach with little additional capex. These could help companies deleverage their balance sheets while improving service and lowering costs—but it would likely require them to adopt a more collaborate stance in partnering with 3PLs, rather than viewing them merely as transactional providers.

Build resilience in the supply chain

COVID-19 has reinforced the need for supply chain resilience and an ability to adapt quickly during times of disruption. Building resilience is a matter of establishing contingencies, engaging in flexible resource planning, and building in redundancy for critical products in the system.

Part of being resilient is building an agile network of suppliers and partners. Mitigating dependencies on geographically concentrated suppliers is one step being undertaken by a number of the major retailers. Retailers who are dependent on offshore production might be well served to consider exploring alternative sources and locations, perhaps developing manufacturing capacity closer to core markets. Rethinking production

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footprints could help drive down risk while providing new value propositions for product that are sourced or made locally.

Need to focus on bespoke analytics

Retailers have historically forecast demand based on sales in prior years. The current crisis has upended the underlying assumptions, rendering these historical statistics less effective. The inability to predict demand has a snowball effect on a retailer's ability to hold the right amount of inventory, plan seasonal merchandise, and avoid unnecessary markdowns.

Advanced analytics for forecasting is now a must for retailers. But the answer is not necessarily to deploy expensive analytics systems; instead, retailers could explore bespoke, plug-and-play solutions that use their existing systems while providing a more credible view of demand trends—and the optimal inventories at each node.

End-to-end visibility

Deploying quickly a supply-chain control tower to orchestrate actions across different functions and improve end-to-end visibility is a key in being able to respond quickly to emerging trends and disruptions. Having increased visibility to help drive strategic and tactical decisions and evaluate the impact on service, cost, and capital is vital in this dynamic environment. Having a strong supply chain control tower enables retailers to respond to unprecedented demand swings by quickly reallocating inventories, analysing and de-bottlenecking warehouse operations, and rebalancing timing of vendor contracts through the use relatively simple tools linked to existing data streams and requiring little or no capital expenditure.

Those retailers who have experienced robust growth over the past decade have largely done so by placing supply-chain optimisation front and centre of its strategic agenda. A supply-chain strategy that is focused on the sustainable creation of value with the retailer environment and places the customer as its centrepiece using the key five initiatives will likely prove to be the most critical factors to win in the next normal.

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Omnichannel building block	Near-term actions (0–3 months)	Mid-term actions (3–6 months)
Customer-centric supply-chain model	Analyze the extent of shift in consumer sentiment and channel preferences to model demand in the new normal	Closely monitor seasonal demand shifts and refine forecasts
Network and ecosystem of the future	Identify quick-win opportunities to optimize product flows through nodes (eg, sending material directly from vendor to store or from import deconsolidation warehouse to store)	Repurpose stores either partially or fully to serve as fulfillment centers for e-commerce
End-to-end planning and information flow	Revise safety stocks and inventory-allocation algorithms to ensure enough stocks in digital channels	Quickly deploy bespoke advanced analytics tools to enable dynamic optimization of allocation, markdowns, and promotions based on new demand patterns
Omnichannel fulfillment and node operations	Reorganize distribution center (DC) operation schedules to preserve social distancing and other safety considerations Ensure enough staffing for increased e-commerce operations (eg, each-picking)	Improve visibility in DC operations by deploying digital performance management to indentify bottlenecks Accelerate automation improvements in conjunction with future network strategy
Omnichannell fulfillment—transportation and logistics services provider management	Conduct market events by factoring in changes to shipment volumes by lanes Partner with local delivery services (and gig-economy players) to improve service and cost economics for expected increased parcel volumes	Improve visibility and use dynamic routing optimization using real-time analytics to quickly respond to demand shifts
Digitization and process automation	Revew portfolio of digital investments that were put on hold to identify no-regreat digital initiatives for the next normal	Leverage bolt-on analytics tools to augment current digital and analytics capabilities with minimal investment
Operating model and change management	Embed safe working policies across the organization Rebalance roles and responsibilities to service increased demand in digital channels and the consequent higher use of analytics	Identify gaps in analytical and technical capabilities to redeploy and upskill employees across functions

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