

AMAZON'S MOVE INTO DELIVERY LOGISTICS

CONNECTING THE DOTS



Many industry players and experts are waiting anxiously to see what innovations Amazon will come up with next – and above all, whether Amazon will enter into delivery logistics under its own banner.

Like no other retailer in the e-commerce space, Amazon has driven innovation at all customer touch points as a means of continuous competitive differentiation – from introducing its Prime service to enabling same-day at scale and pushing for Sunday deliveries. Amazon knew that differentiation that included the use of postal services would not hold for long, and so has invested heavily into regional warehouses, a powerful IT backbone, and detailed analytics. In particular, there is no data point that Amazon does not analyze frequently and in detail to better understand customer behavior and thereby quickly adapt – whether this involves changing webpage design or new functionality in delivery and return choices. And now, there are clear signs that this data is prompting Amazon to shift its attention to the end delivery process.

WHAT AMAZON COULD DO...

Amazon represents 25 to 35 percent of total parcel volumes for some large postal organizations on an average day; yields are low but quality requirements (including detailed controls) are high. A single customer like this provides ideal large-scale density for a logistics provider. But it also means that a provider must adapt sorters and operations to generally small-size parcels and develop distinct processes (for example, to handle an Amazon trailer with 2,500 parcels that arrives 10 minutes before the cut-off at the entry gate of a depot).

Based on our analysis of Amazon's latest strategic moves, it appears that this e-commerce giant is quietly developing a decent footprint in and knowledge of delivery logistics through pilot programs and cooperative ventures, such as same-day delivery, Sunday service, fresh grocery delivery, and even its nascent drone program. More to the point, however, is that Amazon has already acquired or partly controls delivery logistics players in several European countries: In the UK, for example, Amazon has acquired a minor stake in Yodel, which, with 145 million shipments per year and more than 5,000 delivery trucks, is a large player in that market. Amazon's recent move to introduce the Pass My Parcel service in collaboration with Connect Group at more than 500 news agents and convenience stores has set new standards for same-day delivery in the UK. In France, thanks to a 25 percent stake in Colis Privé, Amazon has gained significant control over a player with more than 25 million shipments per year and 1,700 delivery trucks.

Certainly these are not threatening scales, given that an estimated 180,000 delivery vehicles traverse European streets every day, but these initial moves do provide Amazon with a couple of critical aces in the game:

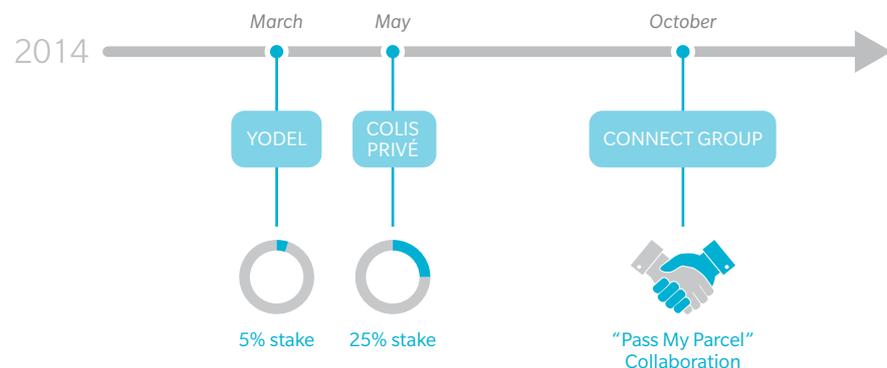
- First, gaining direct control of delivery vehicles allows Amazon to push forward in terms of innovation and differentiation, including how to optimize tours and better connect software on the scanner to Amazon's IT.
- Second, Amazon is building management experience for sorting center operations and a (potentially outsourced) delivery fleet, which could allow it to scale operations up at the right places (mainly urban locations) at the right times – most likely coordinated with the opening of local warehouses.

As a result, Amazon could start to “cherry pick”: make its own deliveries in the most attractive urban neighborhoods, likely coupled with a white label service for customers who have their goods “fulfilled by Amazon” and selected others. We have done the math – this option would work and would be profitable for Amazon. Moreover, it would enable Amazon to truly differentiate its downstream service from the competition and offer easy returns and additional services, such as ad-hoc shopping.

Thinking about fresh grocery delivery, this service could offer even greater potential, as it would be much easier to integrate cold-chain requirements. On the upstream side, it also would make Amazon increasingly attractive for sellers who use Amazon's Marketplace and ultimately its fulfillment service.

For Amazon's logistics providers, however, this scenario could result in dramatic reductions in revenue and end-customer contact, as well as an increase in per piece costs in attractive urban and suburban areas due to reduced density (in Germany, for example, this could impact as much as 70 percent of the population).

Exhibit 1: Recent Amazon Moves Into European Delivery Logistics



...BUT WILL AMAZON JUMP?

Of course, Amazon is unlikely to be interested in physically delivering parcels where and when it is not financially feasible, such as in rural areas (in the absence of drone delivery at scale) or to meet peak demand during the winter holiday season. Parcel companies should not be afraid of being replaced. But what might be worse: they could be marginalized.

Amazon also is up against the wall in terms of the losses its investors are willing to accept. Declining share price over the past year and stock price drops after negative earnings reports are a clear sign that large investments at scale, such as into warehouses, sorting facilities, or even fleets, are unlikely to happen in the near term. (Although this does not exclude partnerships and non-capital intensive means of controlling assets.)

Furthermore, Amazon is focusing sustained attention on other aspects of delivery logistics – not the least of which is expanding its product palette to ensure a competitive fresh grocery offer, as well as trying to convince conservative fresh-offline shoppers (such as in Germany) that Amazon can offer a superior service.

Exhibit 2: Amazon Fulfillment Centers in Europe



Note A series of regional delivery hubs/consolidation centers in the UK have been opened by Amazon Logistics in Croydon, Bromley-by-Bow, Wednesbury (Birmingham), Abingdon (Oxford), Milton Keynes, Southall, Nottingham, Manchester, Leeds, and Southampton, with three additional facilities scheduled for Yorkshire, the Midlands and the northwest.

Source MWPVL International, Inc.

COUNTERING AN AMAZON DELIVERY STRATEGY

Obviously, logistics and postal businesses won't find it easy to deal with any move by Amazon into the physical delivery space. It comes down to a prisoner's dilemma: The danger a logistics player faces by having a high share of Amazon parcel volume is as great as the danger of this volume being in a competitor's network.

To prepare for the possibility of Amazon delivery, Oliver Wyman believes postal and logistics providers should start considering six strategic elements:

1. KNOW YOUR THRESHOLD FOR DEPENDENCE ON AMAZON

Have your house in order, know the parcel (size) and yield mix of each of your customers, and actively steer your sales team to ensure an overall attractive parcel mix in the network. We believe that parcel/postal players should try to limit shares of Amazon-like volumes in their networks to a certain percentage, to reduce the risks of such dependence.

2. INNOVATE LOGISTICS FASTER AND BETTER THAN AMAZON

Get back into the driver's seat and think from the customer's perspective. Predicting the delivery of a parcel within one hour is still an operator mindset, not a customer mindset. When customers purchase goods online, selling them on customer-defined (and fee-based) delivery slots is far more innovative. Such innovations should be folded in to existing tour planning and scanner software.

3. WATCH INDUSTRY CONDUCT CLOSELY

Postal/parcel companies need not be pure price-takers when confronted by e-commerce giants such as Amazon. Generally there are only a few postal/parcel companies in any single-country market, so they do possess a certain power to negotiate. At the same time, players must watch their competitors closely and anticipate actions and reactions, particularly where networks are parallel enough that large e-tailers might easily shift volumes between different providers.

4. GO UPSTREAM WITH PARTNERS

There is plenty of room to go upstream with partners and offer fulfillment, warehousing, and even online shopping. DHL, for example, partnered with a couple of e-players to set up meinpaket.de, Germany's third largest online marketplace, with more than 10 million product listings. By moving upstream in the value chain, DHL now profits from a stable base of parcel volumes.

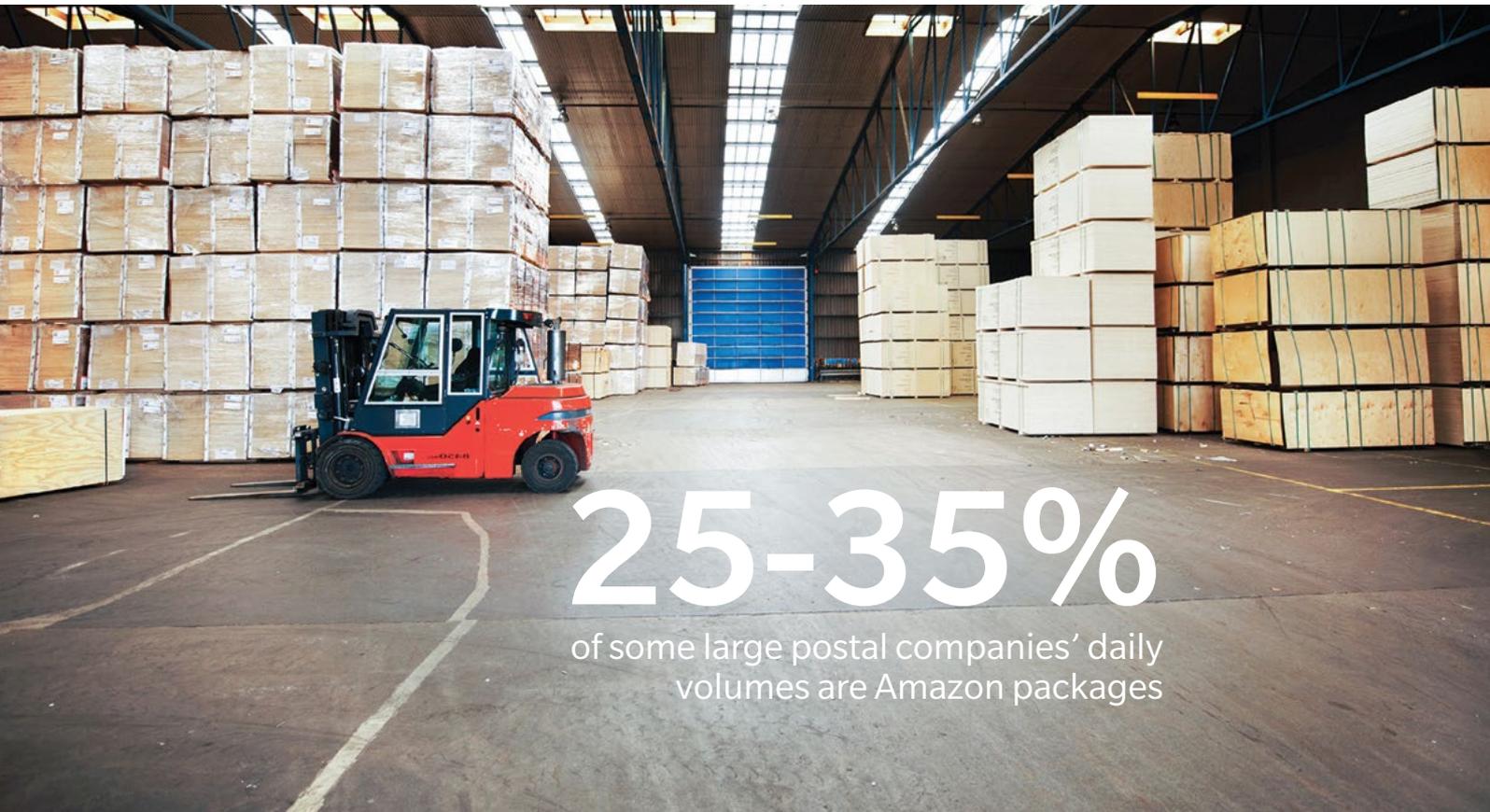
5. DISINTERMEDIATE AMAZON

Recently, Alibaba's logistics partner, ZTO Express, announced it was launching a China to Europe express delivery service with La Poste, the French post office. There is certainly potential for Alibaba to expand such partnerships. More radically, it could fulfill shipments using European warehouses and local logistics networks. This would hit Amazon where it lives, by getting decent quality but cheaper products to customers at scale, and as fast as Amazon does now. Such a move would be disruptive for other online (and potentially off-line) retailers as well.

6. DEVELOP A TRUE PARTNERSHIP WITH AMAZON

Opting for a long-term partnership would give Amazon the control and access it requires while protecting the partner company. Given all the uncertainties around Amazon's long-term profitability and reactions from other e-tailers, this strategy might not be easy, but it is certainly worth considering. Besides the classical path of a volume-based partnership, there also may be room for more innovation-based partnerships as well.

In summary, each logistics provider will need to determine for itself the best strategies on this list to pursue, based on its unique network configuration and operational and customer perspective. None of the options above are a perfect solution. But if parcel/postal companies do not act soon, they will miss any chance to take the driver's seat – and could end up stalled behind the Amazon truck instead.



25-35%

of some large postal companies' daily volumes are Amazon packages

OLIVER WYMAN'S APPROACH TO ON-DEMAND DELIVERY

Evolving e-commerce dynamics have sent the delivery logistics sector into turmoil, with all players now in search of innovative offerings. Current delivery options are weakest in terms of putting the customer first. As noted, they are designed from a service provider's mindset, not a customer's mindset. Truly customer-centric delivery options give the customer full control, throughout the logistics process, on when and where they receive parcels.

In our work with clients in the postal/parcel sector, Oliver Wyman has developed a number of innovative approaches to on-demand delivery. These include:

- Pricing on-demand delivery slots in combination with dynamic yield management. For example, depending on demand, the fee to deliver a parcel between noon and 1 p.m. might be higher than for deliveries between 10 a.m. and 11 a.m.
- Adding on-demand delivery to existing operations through the use of smart network algorithms, with the result that no major changes to current processes and systems are required.

Modeling results have shown that building on these innovative approaches to implementing on-demand delivery is not only operationally feasible but cost efficient.

For more information on Oliver Wyman's approaches to e-commerce logistics, contact your account representative or one of the following partners:

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