

THE EMERGENCE OF OMNICHANNEL OPERATIONS IN B2B

HOW TO SURVIVE AND WIN



ONLINE WILL BE \$1.2 TRILLION B2B TRANSACTIONS BY 2020. WHAT ARE YOU DOING ABOUT IT?

The online channel is becoming increasingly important in B2B transactions: while it represents a \$700 billion business in the US today, it is set to top \$1.2 trillion by 2020. More important, Amazon and Amazon-like offerings have led B2B customers to expect the same experience from their distributors as when shopping online. B2B customers are expecting more and more to be able to discover, buy, receive, and return products seamlessly across multiple channels: in short, they want to fully benefit from the omnichannel experience.

For distributors, this creates challenges and opportunities. While product manufacturers and online distributors can bypass distributors and go direct to customers, traditional distributors can leverage their unique strength in the supply chain to grow, and to reinvent their businesses and relationships, in order to become platforms or marketplaces for customers.

There are clearly many front customer facing issues like what channels do you need, how do you engage the customer through various steps in their lifecycle, and what roles different channel plays. In the main, distributors can and are moving quickly to try different things that might work on the front, including digital channels, omnichannel engagement, and multiple touch points with the sales force. However, few are making thoughtful changes to their back end operations to set themselves up for success.

In this new world, we believe there are two steps that distributors should take to survive and win: 1) use agile approaches to IT and business and 2) focus on the four areas that will help drive customer-centric operations.

AMAZON HAS RESET THE EXPECTATIONS OF YOUR CUSTOMERS

Amazon's bold plans to take B2B ecommerce by storm, as it did for B2C, has captured the attention of distributors and pushed anxious executive teams to assess their risks and test their strategies.

What if everyone has missed the forest for the trees?

Amazon's move was indeed a critical juncture in B2B, but not because of the risk it caused to its competitors. It was critical because of what motivated Amazon to target this sector: B2B ecommerce is already a \$700 billion business in the US (believe it or not, more than twice the size of B2C ecommerce), set to top \$1.2 trillion by 2020¹. B2B buyers are pivoting towards ecommerce, with 68% of them purchasing goods online in 2014, up from 57% in 2013—that is a jump of eleven percentage points in a single year².

¹ Source : Forester Research

² Source : Acquity Group

Perhaps more important, ecommerce is changing buyers' expectations in ways that had not been anticipated. Sixty-five percent of B2B customers feel a service gap versus Amazon and Amazon-like offerings³. As the CEO of a major multi-category distributor puts it: "Our customers have already been trained by Amazon (in B2C) on what good looks like. That's what we have to compete with." In other words, distributors are not competing (yet) against Amazon. They are competing against the expectations that Amazon has set.

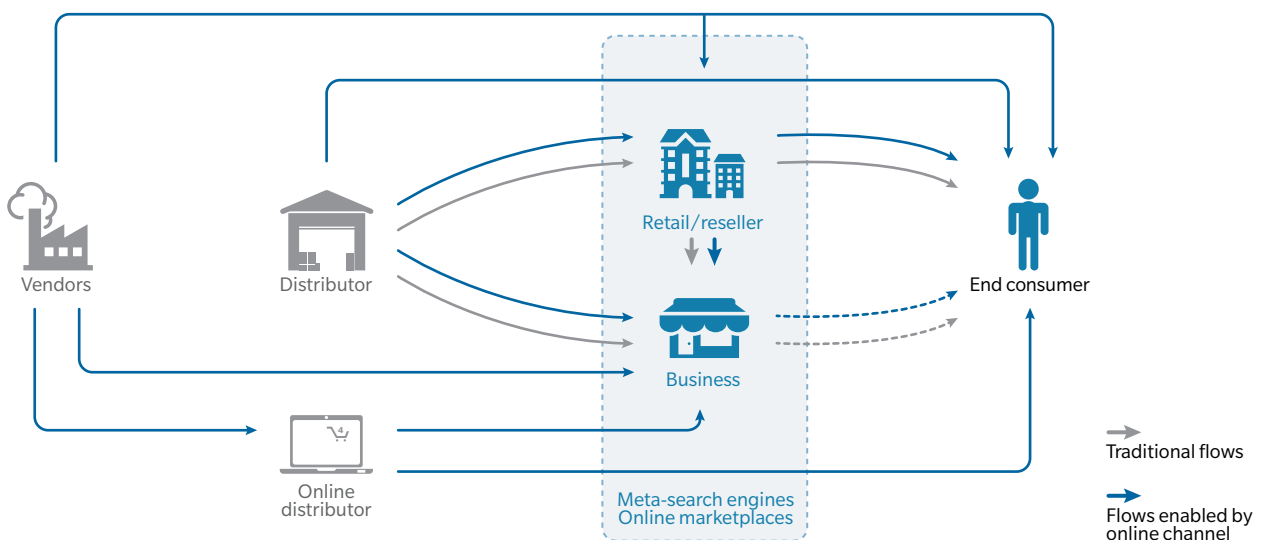
This transition is permanently altering decades-old supply chains where vendors, distributors, and retailers link together and/or compete against one another to better serve businesses and end consumers. Exhibit 1 illustrates how the online channel links with other channels to enable new forms of collaboration and competition. Some of those forms challenge distributors' position in the value chain: product manufacturers can bypass distributors and go direct to retail, businesses, and end-consumers, as can online distributors. Others provide distributors with opportunities to leverage their unique strength in the supply chain to grow: retailers or vendors can drop-ship consumer orders to them for items they do not stock or cannot pick-up in their distribution centers.

For all players, omnichannel requires a shift in mentality. We believe this means that distributors need to change their operating mindset from cost-centric to customer-centric.

This paper presents a new way of thinking about the operational implications of omnichannel distribution; namely, **distributors should take two steps** to survive and win in the new world:

1. **Use agile approaches to IT and business** – focus on long-term consumer trends and continuously adapt to an evolving target
2. **Four things you need to do** – these areas will help drive customer-centric operations: dynamic network design and order fulfillment, last mile and delivery, integration with vendors, systems and technology innovation

Exhibit 1: Traditional and Online Enabled Flows



3 Source: LMA Consulting Group

1. USE AGILE APPROACHES TO IT AND BUSINESS

Traditionally, distributors have grown operations sequentially. Expansion plans are laid out and executed in a series of planned steps over several months or even years. However, given the rapid pace of change of both consumer behavior and technology, this incremental approach carries a risk. It is becoming more difficult to predict what the channel landscape will look like in two to three years, let alone five to eight, much less define and plan for what is essentially an unknowable end state.

Not only will buyer needs continue to evolve, omnichannel will likely mean different things to buyers in various markets and sectors. We believe that distributors should design their operations to be flexible enough to support long-term trends that are applicable across different sectors and geographies, such as:

- More **access points**: online, mobile, stores, click-and-collect, lockers, pick-up and drop-off points, parcel shops
- More **delivery options**: after-hours and weekend delivery time slots
- Shorter **lead times**: same-day and next-day delivery
- **Seamless experience** across access points and channels

Understanding where the buyer is going and designing the offer intelligently (and profitably) to stay one step ahead is the secret to success. Any long-term plans are almost certainly going to need to be revisited every six months given constant changes to buyers and technology. To be agile, distributor operations will need to:

- Think of the end state as an evolving target and adopt a continuous improvement mindset
- Focus more on incremental steps and “sprints” rather than a sequential “marathon,” where it is better to make progress frequently and tangibly in weeks and months, not years
- Consider working tests and live proof of concepts that impact the customer as the primary measure of progress
- Plan for experimentation and failure, fail quickly and cheaply
- Place a high value on simplicity, speed, and nimbleness
- Constantly reflect on progress and be faster, simpler, and more efficient

2. FOUR THINGS YOU NEED TO DO

While virtually every distribution process is affected by omnichannel, we believe that four key strategic “bricks” of distribution operations are critical to support the transformation to customer-centricity:

- **Change how you think about designing your network and fulfilling orders**
- **Consider a variety of options for last mile and delivery**
- **Aggressively integrate upstream and downstream to lower total cost in the value chain**
- **Build and partner for the right tech capabilities**

CHANGE HOW YOU THINK ABOUT DESIGNING YOUR NETWORK AND FULFILLING ORDERS

The development of ecommerce and the proliferation of new services will force distributors to review their traditional network design and order fulfillment operations. While distributors traditionally relied on distribution centers, they will leverage a dynamic network of locations in the new world, using a combination of warehouse picking, branch picking, drop-shipping, and fulfillment from vendors' distribution centers. Exhibit 2 lays out the rationale of each approach.

Exhibit 2: Main Fulfillment Approaches

APPROACH	RATIONALE	USE CASE
Warehouse picking	<ul style="list-style-type: none"> High picking productivity on a broad range of SKUs for next-day delivery Can be dedicated to online or shared with brick-and-mortar 	<ul style="list-style-type: none"> Retailer, reseller, business, home delivery
Branch picking	<ul style="list-style-type: none"> Offering a broad range of SKUs within two hours with minimal investment 	<ul style="list-style-type: none"> Ship-from-store Click-and-collect
Drop-shipping	<ul style="list-style-type: none"> Expanding range of long tail of SKUs not sold in store through partnerships with vendors and wholesalers 	<ul style="list-style-type: none"> Retailer, reseller, business, home delivery Endless aisles
Fulfill from vendors' DCs	<ul style="list-style-type: none"> Very high volume SKUs, allows to cut costs and inventory and accelerate delivery 	<ul style="list-style-type: none"> Retailer, reseller, business, home delivery

Designing a dynamic network will require considering elements online versus the in-store range, CAPEX spending, pick-pack-ship volumes, access points, and lead time.

CONSIDER A VARIETY OF OPTIONS FOR LAST MILE AND DELIVERY

Delivery costs and services are among the most critical factors in choosing where to shop online. This has turned the last mile into one of the most powerful ways to differentiate in the market.

Incumbent transportation carriers have for decades built hub-and-spoke infrastructure and fixed delivery waves to offer overnight or next-day delivery services for mid- to long-distance destinations. This model will increasingly become irrelevant for the last mile. Despite their density, distributors' delivery networks are not built to serve individual buyers with small orders.

Online leaders such as Amazon and Google have invested more aggressively in last mile innovation than retailers and distributors:

- Amazon is building its own delivery infrastructure for same-day delivery and next-day delivery as well as for Amazon Fresh, while dynamically evolving its partnerships with USPS, UPS, FedEx, and others
- Google has built its own delivery network to support the growth of Google Express

This (meaning Amazon and Google) is shaping the way suppliers and transportation companies redesign their operations.

Reflecting on how this impacts their own business model, distributors will have to consider three options to innovate in this space:

- Transform their proprietary delivery capabilities where they have volume and density
- Leverage radically new solutions offered by start-ups such as Uber and Collect+
- Push their traditional suppliers to innovate more and rethink delivery models. Leading global parcel carriers DHL and UPS are already experimenting with new approaches to delivery rounds modeling, allowing them to adjust routes and truck deployment in real time

AGGRESSIVELY INTEGRATE UPSTREAM AND DOWNSTREAM TO LOWER TOTAL COST IN THE VALUE CHAIN

As part of Amazon's Vendor Flex program, P&G allowed Amazon to set up fulfillment operations within its own warehouses to reduce transportation costs and speed up delivery. While vendor-managed inventory and other collaborative projects have existed for decades, this partnership is among the first in the online space.

Vendors are making considerable investments in direct-to-customer capabilities and partnerships. Given the scale required to serve consumers, we believe that it will be in vendors', retailers', and distributors' interests to work more closely to take an end-to-end view of the supply chain. Areas of focus will include:

- End-to-end **distribution** approach, drop-shipping: retailers are constantly expanding their online range, which opens up an avenue for distributors to deliver drop-shipping services focusing on the long tail of SKUs not stocked by the retailers
- Integrated **planning** and forecasting, leveraging big data: bringing together market insights from across the value chain will enable to more accurately forecast revenue and reduce inventory levels while improving on-shelf availability
- Real-time visibility on **inventory** and orders: retailers, vendors, and distributors will need a platform to dynamically route orders to the most competitive center, based on inventory availability
- Real-time **replenishment**: fulfillment centers require very high levels of product availability, which require more frequent replenishment and lower minimum order quantities
- Differentiated **packaging** for online versus in-store: online volumes are reaching the critical mass that justifies dedicated packaging, better suited to online merchandising and delivery

This reflects our view that the Intelligent Distributor will over time morph into marketplace intermediary, building more intense relationships upstream with vendors and downstream with customers. (See our publication, *Intelligent Distribution: Making your business more commercially effective.*)

BUILD AND PARTNER FOR THE RIGHT TECH CAPABILITIES

Omnichannel is bringing a radically different set of challenges and requirements that are often incompatible with legacy systems and technologies, such as:

- **Visibility** and **single view** of product, inventory, customer, and order data across channels and stakeholders
- **Real-time** decision making on operational dimensions (inventory management, delivery tracking, etc.) and commercial decisions (pricing, channel focus, salesforce deployment, etc.)
- **Orchestration** of multiple stakeholders such as vendors, 3PLs, transportation companies, ecommerce platform, ERP, etc.
- Technology-enabled **breakthrough** in productivity and services such as picking technologies and automation, in-store kiosks, etc.

How can distributors evolve their systems to enable customer-centric operations? @Walmartlabs is showing one possible way with 15 acquisitions conducted since 2011.

CASE STUDY

@WALMARTLABS

@WalmartLabs was established in 2011 in Mountain View, California, as Walmart's digital R&D and innovation center. Since then, the company has acquired 15 start-ups and hired more than a thousand workers, to reach more than 3,500 employees. It operates in areas such as online community, search and discovery, predictive intelligence, and cloud-based services for ecommerce and operations.

CONCLUSION

The rapid growth of ecommerce is reshaping the distribution ecosystem and the balance of power among vendors, retailers, online players, distributors, and logistics groups. There is a fundamental shift in the way buyers shop, thereby increasing complexity for distributors. Distributors risk losing buyers, cash flow, and control on key elements of their value chain.

To survive and win in this context, we believe distributors need to shift their operations from cost-centric to customer-centric, focus on four key "bricks," and become more agile to adapt to an evolving target.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

In the Distribution and Wholesale practice, we draw on unrivaled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in distribution and wholesale: an obsession with attracting, serving, and growing customers, constant dedication to operational excellence, and a relentless drive to improve capabilities. We have a track record of helping clients win in this environment, creating real competitive advantage and driving significant growth. We believe our hands-on approach to making change happen is truly unique – and over the last 25 years, we've built our business by helping distributors and wholesalers build theirs.

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