MULTICHANNEL MERCHANT

MCM OUTLOOK 2019

# The Customer Expectation Chase Continues

By **Mike O'Brien,** Multichannel Merchant

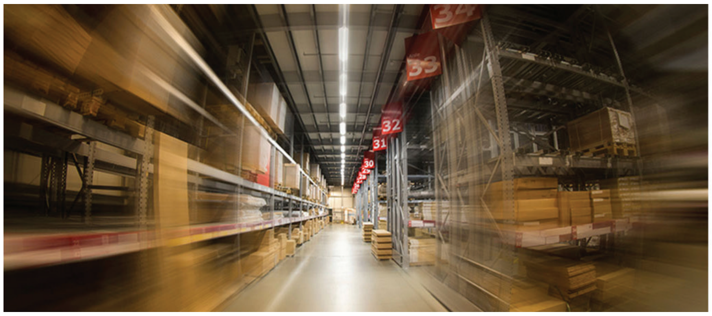
Amazon may have started out raising the bar on customer expectations with Prime's guarantee of free two-day shipping on all ecommerce orders, but the pressure has been kept up since industry-wide as merchants large and small scramble to meet increased fulfillment demands and not get swamped in the process.

As ecommerce continues to grow at about a 15% clip per annum, operations and fulfillment resources are stretched to the max. This leads to challenges like scarce and more expensive labor, a tight market for facilities, ever-rising shipping costs and the need to invest technology and systems to push more orders through the pipeline faster and more efficiently.

For instance, on the labor front ecommerce distribution and fulfillment centers need to hire an additional 226,000 warehouse workers in 2019 just to keep pace with demand, according to commercial real estate firm CBRE. This is more than 45,000 over the average of 180,300 new operations/fulfillment worker hired in the sector each year since 2013.

"Increasingly, development of ecommerce warehouses is contingent not only on close proximity to large customer populations but also on finding increasingly scarce labor," said David Egan, Global Head of Industrial and Logistics Research for CBRE.

In our annual MCM Outlook report we will look at a number of key areas impacting ecommerce operations and fulfillment, based on results from our annual audience survey. We'll also examine the drivers behind the trends and what companies are doing to stay ahead of the curve in a brutally competitive market.




## Fulfillment Labor Issues Become Heightened

CBRE estimates that a $1 increase in average hourly wages for a typical warehouse with 500 employees raises annual labor costs by more than $1 million. This figure is higher for high-production ecommerce operations, especially during peak season. And wages for fulfillment workers continues to rise as demand for workers is high in a period of historically low unemployment, 3.8% as of February, 2019.

The options open to retail and ecommerce firms, delivery providers and third-party logistics firms, according to CBRE, include recruiting warehouse workers from other industries; investing in automation to enhance labor efficiency; or expanding into markets with a strong labor supply.

In its annual report on warehouse employment, Prologistix found the average hourly wage among 16,000 workers surveyed was $13.30, up from $10.46 in 2012. A rate of $12 per hour was seen as the floor for ware-

CONTINUED ON PAGE 2

house associates surveyed. Sixty-five percent said they make at least that much, up from 59% in 2017 and 36% in 2016, a rapid rise.

In July 2018 the Bureau of Labor Statistics noted a 2.7% year-over-year increase in U.S. wages, while the hourly rate for warehouse workers has increased 6.7% since 2017, according to Prologistix.

An indicator of the high demand is the fact that 36% of warehouse workers said $1 per hour was the minimum shift differential they would accept today. Given the tight market and high demand, associates can often find another warehouse job within hours, not days or weeks, said Brian Devine, president of Prologistix.

"Four or five years ago if a company offered 35 cents or 50 cents in shift differential, that was enough to move needle to get the workers they needed," Devine said. "That's simply not the case today."

Some suggestions from experts on attracting and retaining a sufficient level of operations and fulfillment workers include instituting "refer a friend" and performance bonuses, working with local temp agencies, hitting job fairs, setting up a recruiting website, identifying your churn rate and capturing reasons for leaving to address issues.

> *"Four or five years ago if a company offered 35 cents or 50 cents in shift differential, that was enough to move needle to get the workers they needed. That's simply not the case today." - Brian Devine, President, Prologistix*

## Automation and Robotics on the Rise

Given productivity demands and acute labor issues, it's no surprise that automation and robotics are high on the priority list for many merchant companies. Nineteen percent of respondents to the MCM Outlook survey said they planned to pursue investment in robotics in 2019, up from 4% in the prior year. Eight percent said they would invest in warehouse automation this year, up slightly from 7% in 2018.

"Everything has to go faster, with flawless accuracy, and retailers need to lower costs," said Perry Belcastro, SVP of Fulfillment Services for 3PL Saddle Creek Logistics Services. "Automation plays into that. With unemployment so low, it's harder to just add staff to an FC – that doesn't work for large-volume fulfillment."

Belcastro said Saddle Creek has been looking at robotic solutions for this reason. "The challenge, when funding new technologies, is achieving the necessary ROI to make sense from a business standpoint," he said.

Examples of new robotic implementations abound in retail and ecommerce. Just in March, 2019, fast fashion brand Tobi selected picking robots from inVia Robotics to improve picking accuracy and efficiency in its Reno, NV fulfillment center. And FedEx plans to test autonomous delivery bots in the summer of 2019 in its hometown of Memphis, TN.

The implementation of robots is only going to accelerate in the coming years as companies seek to increase productivity and improve the customer experience. Research firm IDC predicts that by 2021, 60% of the world's 2,000 largest companies will have deployed autonomous mobile robots.

"We've seen from early adopters that once the fully loaded hourly labor cost reaches $15 to $16, robotics can be cost justified," said Brian Barry, president of F. Curtis Barry & Co. "They work longer without needing breaks and can run from 12 to 14 hours on a charge. As labor availability becomes tighter and wages push up, more companies will find a profitable application."

Automation, including robotics and autonomous vehicles as well as more standard technologies like pick-to-light, goods-to-person and automated storage and retrieval (ASRS), addresses the labor shortage by increasing efficiency. Based on different industry measures, companies can realize productivity gains of up to 46% from warehouse automation, Barry said.

## Distribution, Fulfillment Space Is at a Premium

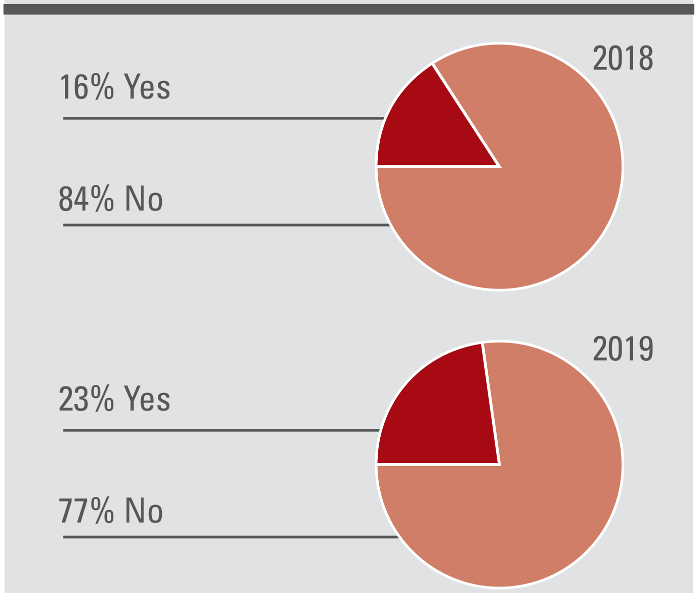
A historically tight market for warehouse space is forcing ecommerce companies and fulfillment providers to get creative, including conversion of former retail stores; forward placement of inventory in smaller buildings near urban centers; a handful of multistory warehouse developments in major markets; and the increasing use of third-party logistics (3PL) partners.

Getting back to the ecommerce delivery expectations begun by Amazon, everyone is moving toward the magic two-day delivery target as the benchmark to hit, and setting up their fulfillment networks accordingly. 3PLs are one way that more of them are making that happen, partnering with companies that have strong networks and core competencies in logistics and fulfillment.

"From a delivery standpoint, you want to get inventory as close to the customer as you can," said Belcastro. "You don't need a distribution hub on every street corner, but two to four strategically placed in the U.S. allow you to compete and deliver in one to two days at a reasonable cost. That's the ideal position to be in, for someone who doesn't have the capability to put locations in every state like Amazon."

While use of a 3PL is not a practice of the majority of shippers, it is growing. Twenty-one percent of respondents to the 2019 MCM Outlook survey said they are currently using a 3PL, up from 16% in 2018. Another growing trend is the use of so-called "warehouse as a service" providers such as Flexe, Darkstore or Flowspace that match unused space with shipper demand on a short-term basis, often by partnering with 3PLs.

Do you currently use a 3PL partner?




To get an accurate comparison between keeping fulfillment in house and outsourcing to a 3PL, it's important to account for internal fulfillment services provided by other departments, advises Barry. This is important because a 3PL will include all costs such as fulfillment center space and utilities, IT, communications and equipment, recruiting, benefits and management.

According to Barry, four considerations to help you arrive at a fully loaded cost per order in both scenarios include:

- Creating a business profile of the services required and transaction volumes.
- Identifying every component of the fully loaded cost per order for your internal fulfillment.
- Sending out an RFP to qualified 3PL vendors that meet your high-level criteria. Request a three-year projection of all costs by year indicating any factors used to increase services.
- Develop an accurate apples-to-apples comparison between internal fulfillment and each individual 3PL providers' proposed costs.

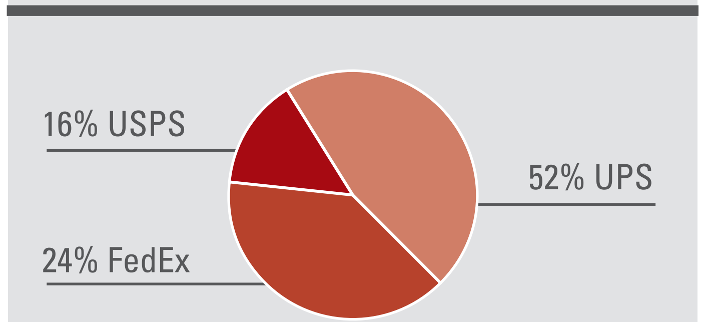
## Carriers Costs Causing Shippers Headaches

Every year shipping costs continue to rise unabated, with a continual flow of carrier GRIs and accessorial fees, and now the U.S. Parcel Service is increasing parcel rates as well and expanding dimensional pricing. Merchant companies, especially SMBs, are caught in the crosshairs and having a hard time keeping up.

As of Jan. 27, 2019, Priority Mail Express rates from USPS increased 3.9%, while Priority Mail saw an average increase of 5.9%, higher for those using commercial-plus pricing. First Class Package Service for items under 1 lb. saw the biggest jump, at an average of 11.9%, while implementing zone-based pricing for the first time.

FedEx and UPS were once again in lockstep on their GRI increase of 4.9% for 2019, but as always, a host of factors plus numerous special handling and accessorial charges drive costs substantially higher. UPS was cited as the primary carrier by 52% of MCM Outlook survey respondents, followed by FedEx (24%) and the USPS (16%).

Who is your primary carrier?



Shippers will also face a major adjustment when the USPS DIM factor is adjusted down in June, said Rob Zaleski, digital content and brand manager for shipping software firm ShippingEasy, something they've grown accustomed to with UPS and FedEx.

"They have to be smarter and find ways to fit products into boxes as closely as possible," Zaleski said. "When possible, they should use flat rate or regular rate boxes and see substantial savings. The more DIM goes down, the more it's costing them – it's something they haven't had to think about as much with the USPS."

Belcastro said the increased rates from the major carriers has led to greater opportunities for regional carriers as well as couriers and crowdsourced startups. And of course, Amazon continues to loom larger with its ever-expanding delivery and logistics designs.

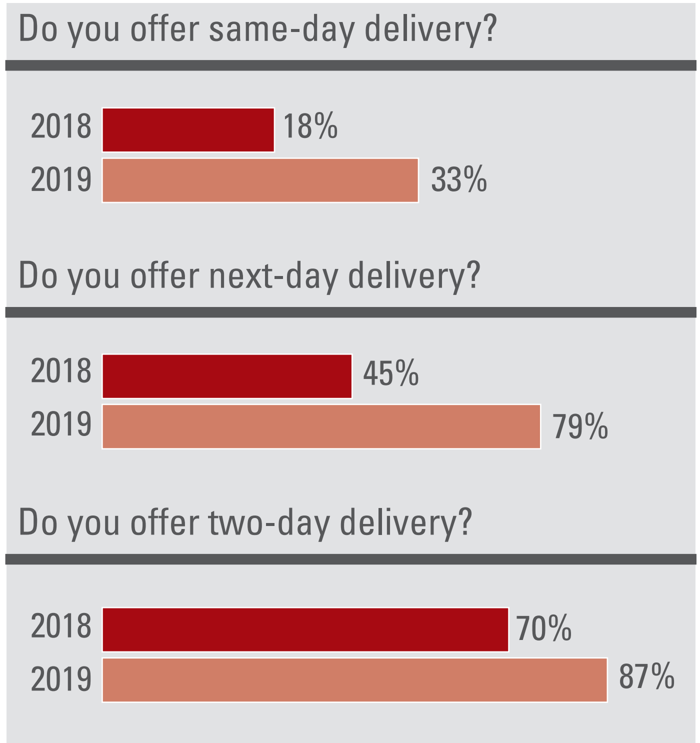
"There are definitely more regional and local carriers active in the last mile space," he said. "They're popping up to help shippers optimize transit times and cost. We're seeing many taking advantage of the growing need for last-mile capacity, with a lot of owner/operators buying vans and marketing themselves."

Belcastro said this activity is concentrated mostly in larger urban markets such as New York, Miami, Los Angeles, Boston and Chicago, where it makes sense from a density and demand perspective. "There are opportunities for it to branch out to the broader U.S.," he said. "It's definitely a trend right now."

## Customer Expectations on Order Fulfillment

While increasing rollouts of same-day and next-day delivery in urban markets continues to get a lot of attention, consumers by and large still favor free or low-cost shipping, convenience and hitting the promised delivery above all. But fast is still sexy and attention-getting.

Respondents to the MCM Outlook survey have gotten the memo on rising expectations for delivery speed. When asked if they offered same-day delivery, 33% said yes, up from 18% in 2018, while 79% offer next-day delivery, up from 45% a year ago. The vast majority (87%) offer two-day shipping to hit the Prime expectation, up from 70% a year ago.




According to a 2019 survey of 1,000 consumers in the U.S. and Canada by Metapack, 61% of them cited free shipping as the top consideration for the majority of their purchases. However, the survey also found many willing to pay expedited fees for faster delivery or a more convenient option: 81% in the U.S. and 69% in Canada expect to pay extra for one-hour, same day, next day or Sunday delivery.

"Everyone wants no cost, next day or same day, so retailers need to leverage a network of locations and manage inventory across all of them, positioning DCs as close to consumers as possible," said Belcastro. "If a retailer puts up a free same-day shipping offer, people will bite but the question is, do they need it? What's really more important to the consumer based on their delivery needs is having it there when you say it will be and meeting their fulfillment expectations."

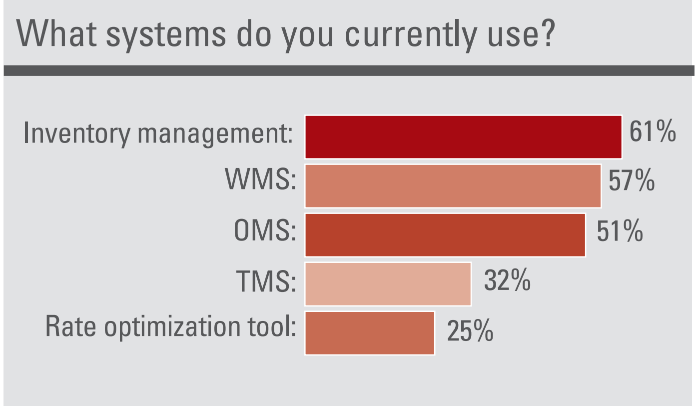
## OMS, Inventory Management Head Tech Investment Wish Lists

After robotics and automation (cited by 19% of respondents), order management systems (OMS) and inventory management systems were highest on the priority list for technology investment in 2019, based on the MCM Outlook survey, noted by 12% of respondents each.

"When you're carrying a depth of inventory in multiple locations across the country, you need technology to manage that," Belcastro said. "A robust OMS can help manage a highly complex distribution network to optimize delivery time and cost while providing real-time product visibility to consumers."

The state of the art for OMS and inventory management, as well as WMS and automation controls like WES and WCS, has advanced significantly in recent years as omnichannel operations have added layers of complexity to the flow of inventory and orders between DCs and FCs, stores, manufacturers and marketplaces. Also, the latest systems do a better job of helping companies trim rising shipping, logistics and supply chain costs.

This trend is reflected in the MCM Outlook results, as more companies have implemented various systems to drive greater efficiency and cut costs. Among respondents, 61% said they currently use an inventory management system, followed by WMS (57%), OMS (54%), TMS (32%) and parcel rate optimization tools (25%).




David Strobelt, CIO of Modell's Sporting Goods, said customer expectations have raised the bar considerably for retail and ecommerce companies in terms of tech investment imperatives, especially for OMS.

"Retailers nowadays consider a complete dashboard with performance metrics and drill-down analytical tools basic table stakes to manage their real-time inventory and order fulfillment tasks," Strobelt said. "There is also a growing desire for advanced machine learning algorithms to automate fulfillment optimization and capitalize on opportunities at scale, while quickly making course corrections as unique customer issues occur."