Point of View

The Operational Implications of Omnichannel Retailing

How Creating a Balanced Retail Strategy Can Increase Basket Size, Grow Conversion Rates, and Reduce Inventory Losses

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Retailing is in the throes of multiple market transitions.

Technology has reshaped the retail industry—irrevocably changing where and how retailers sell their products and services to customers. Online retailing has created a whole new class of competitors across all industry segments, pushed brick-and-mortar retailers into digital channels, and is now by far the fastest-growing channel worldwide. The rapid rise of always-connected personal devices has also placed unprecedented levels of price and product information at shoppers' fingertips.

In addition, the retail industry is being transformed by mass production, global supply chains, and mass-market retailers that now offer products previously confined to mid- and upper-tier brands. This is causing retailers to differentiate themselves on the services they offer rather than the products they sell.

A significant demographic shift is also quietly modifying the consumer segments to which retailers offer their wares. With the aging of baby boomers comes an increased demand for services. And as Generation Y (also known as Millennials) enters its primary household formation and employment years, retailers must adjust to meet the needs of a culturally diverse and technology-dependent market.

The impact of these major transitions is being felt by retailers in the form of new shopper behaviors and expectations of a single, integrated, and seamless shopping experience, no matter which device or "channel" consumers use. This new paradigm is often referred to as "omnichannel" retailing, where shoppers increasingly buy virtually anything, anywhere, anytime, using any connected device.

Creating a Balanced Retail Strategy

To address their operational challenges, many retailers have focused the majority of their time and resources creating the best customer experience possible. This involves the first two steps described below—value *creation* and value *capture.* While both are essential to becoming and remaining competitive, the consequence is that less energy and focus are applied to the operational implications of omnichannel retailing.

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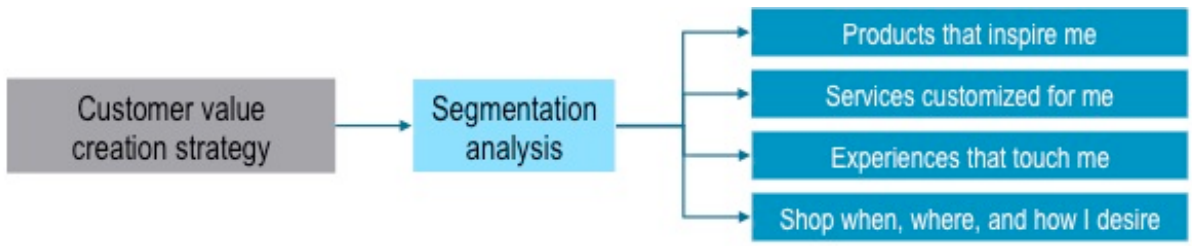
Before we focus on how to improve operations in an omnichannel world, it is important to briefly describe each of the three components that make up a balanced retail strategy:

1. **Value creation.** Except at the lowest price points, value differentiation is now created by combining products, services, and brand-based experiences. With few exceptions, products will continue to be commoditized. Services now comprise both profit-generating SKUs and free capabilities that drive conversion, basket size, and loyalty. Customer experience will become an increasingly important factor affecting a shopper's decision to enter, return, and spend at a brand's point of transaction.

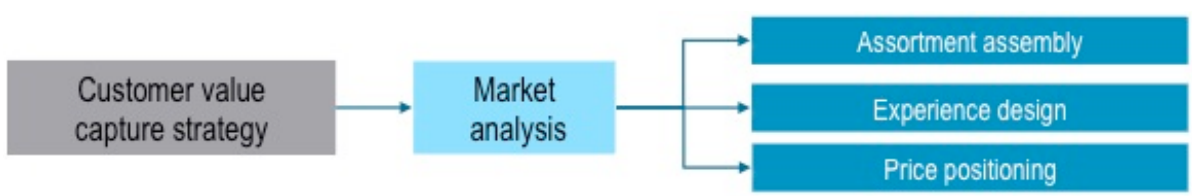
Figure 1. Step One of a Balanced Retail Strategy—Value Creation.



Source: Cisco IBSG, 2012

2. **Value capture.** Capturing value in today's retail environment involves:
   - Speed and intelligence (in other words, knowing critical information sooner and acting on it faster than the competition).
   - Shifting from a supply-chain mind-set to a responsive demand-chain vision where connected vendors reduce development and replenishment cycles, and decrease out-of-stocks.
   - Sensing consumer sentiment through social media and real-time analysis of in-store and online behavior.
   - Price and markdown optimization across all channels, which reduces overall markdown percentages, drives more efficient use of capital, and enables greater returns for one-time purchases and time-based offers.
   - Big Data analysis and real-time data filtering at the edge.

Figure 2. Step Two of a Balanced Retail Strategy—Value Capture.

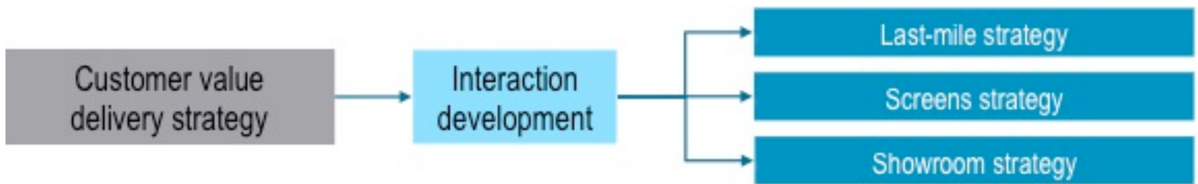


Source: Cisco IBSG, 2012

3. **Value delivery.** Value delivery takes place at touchpoints along the customer life-cycle. In an omnichannel environment, customers not only expect a seamless experience across multiple channels—they want the best of both online and brick-and-mortar worlds. For example, shoppers are now demanding the convenience of buying online with the sensory (see, touch, smell) experience of shopping in stores.

   These demands go beyond today's multichannel retailing capabilities that allow shoppers to purchase products in one channel and return them in another. The omnichannel retailer of tomorrow will communicate with shoppers across multiple screens, operate marketplaces with an extended (even endless) range of products, and provide personalized delivery options.

Figure 3. Step Three of a Balanced Retail Strategy—Value Delivery.



Source: Cisco IBSG, 2012

Improving Operational Capabilities

Given that we are in an omnichannel world, retail executives should ask themselves several important questions with regard to improving operational capabilities:

- What is the vision for our retail operations?
- Which processes deliver value to shoppers and, ultimately, to shareholders?
- Which new capabilities do we need to develop?

To help answer these questions, we created a capability matrix that includes seven critical operational areas that should to be addressed. The matrix also provides a three-stage migration path from the current state of channel independence to a final state of omni-channel optimization. Finally, the last column provides ideas about the capabilities and competencies required to execute the stages. The three stages are:

Stage 1—Disparate channels. This is where most retailers begin their omnichannel journey. The focus of this stage is to sell more products and services by developing channels that extend reach and compete against online retailers.

Stage 2—Channel integration. At the midpoint, processes among channels work in harmony. The focus of this stage is to create demand by connecting touchpoints across channels and by gaining a deeper understanding of the customer journey.

Stage 3—Channel optimization. This is the final (or desired) state. The focus of this stage is to deliver a brand-differentiating experience by integrating and optimizing all processes, capabilities, and data (customer, inventory, and product) to operate as "one" with the customer in the center.

To achieve the best results, we recommend that retailers use the matrix first to complete a self-assessment, and then prioritize the work required to advance from the current state to the desired stage of channel optimization. From our experience, few retailers languish completely on the far left of the matrix (i.e., have completely siloed channels). Most retailers fall somewhere between stages 1 and 2.

When it comes to prioritizing, retailers should consider two variables to guide the discussion—potential impact and time to value. While the development of an integrated, optimized demand chain may produce the greatest rewards, it could take years to complete. Additionally, while the value created by changes in employee revenue recognition and compensation practices may pale in comparison, the impact might begin to be felt across the company in just months. Retail leaders will need to balance the need for quick "wins" against the long-term value that a major project can deliver.

Figure 4. Capability Matrix Helps Retailers Progress Toward Omnichannel Retailing.

	Disparate Channels	Channel Integration	Channel Optimization	Capability Development
Customer touchpoints	Touchpoints owned by traditional functions, managed in silos. Focus on store / website touchpoints.	Customer journey framework used for touchpoint alignment. Touchpoints beyond store / website investigated.	Seamless touchpoint integration delivers total customer experience / revenue opportunities across customer journey.	Customer experience design competency. Cross-channel customer experience design teams.
Interaction platforms (physical, digital, virtual)	Stores are focus for physical space, associate interactions. Websites are focus for digital platforms to display products for e-commerce. Virtual platforms limited to instant messaging / callback for e-commerce.	Interactive digital experiences for in-store product selection. Digital platforms support mobile applications for e-commerce / in-store access for customers. Virtual platforms provide live interaction with remote associates.	Each interaction platform optimized to deliver unique space, product, and associate interactions to any touchpoint. Physical spaces designed around digital platforms to create new, unique experiences with 3-D, virtual reality, augmented reality. Virtual platforms deliver interactions with associates on websites / consumer devices.	Physical, digital, virtual platforms evolve to innovate space, product, people interactions. Digital experience technology platform delivers similar experiences to any device. Digital content capture, creation, distribution chain.
Analytics	Unplanned, disjointed data collection. Customer view available for store associates. Separate analysis of web traffic. Operations data focused on supply chain / store labor.	Framework for systematic customer data collection across channels. Customer data integrated / available across channels. Collection of customer experience data in place.	Data-driven decision making / innovation the norm. Operations data enable customer-experience-linked incentives for associates. Collection, analysis, integration of external (social) data.	Unified, single customer view. Predictive behavioral analysis / emulation applications forecast customer needs. Compelling loyalty / rewards programs identify customers at all touchpoints. Customer experience analytics: in-store video / RFID; context-aware architecture.

People	Customer experience roles limited to in-store (cashiers / customer service clerks), call center agents. Incentives focus on operational metrics / direct sales.	Customer experience leadership, design roles established. Associate tools enable high-touch customer experience delivery.	Customer experience roles exist at every level of organization. Customer experience metrics drive incentive plans at all levels.	Brand-specific customer experience incentive schemes / tools available. Measure associate performance based on amount of customer engagement.
Sourcing / merchandising	Core assortment for stores; extended for e-commerce. Separate merchandising teams / sourcing plans for stores, e-commerce.	Integrated sourcing plan for stores, e-commerce. Digital merchandising team is a new competency.	Segment-specific sourcing plans. Fast fashion, fresh products drive clicks, foot traffic.	Inventory risk management control (for fast fashion).
Fulfillment / returns	Online visibility of in-store availability. “Return anywhere” process in place. Fulfillment centers optimized for shipping.	Click-ship to store. Fast-shipping options offered. Click-collect from store. Click-reserve in store. Click-ship from store.	Dynamic logistics network planning optimizes flow of goods, reduces cost. In-store picking optimized for speed and labor.	Inventory accuracy high enough to enable in-store picking. RFID in use to avoid inventory errors / add picking accuracy. Warehouse automation for single-order assembly, shipping.
Prices / promotions	Products priced differently across channels. Promotions not synchronized among channels. Channels may be competing on prices, promotions.	Prices across channels aligned (online and stores). Promotions synchronized. Channels not competing.	Optimized pricing policy recognizes difference in channel service levels. Policy proactively communicated to consumers. Channels offer choice / complementary service extensions.	Renewal of pricing, service, loyalty strategy due to transparency (comparison) and Amazon pricing model.

Source: Cisco IBSG, 2012

The Benefits Are Worth the Effort

Analysts and academics have repeatedly cited the economic value of omnichannel retailing. McKinsey & Company noted in 2009 that consumers who shop across a number of channels annually spend about four times more than those who shop just in one channel.[1] In addition, a 2008 study employing a random sample of 1 million shoppers purchasing 24 product categories from 750 retailers over a four-year period showed that the monetary value of an average multichannel customer is about 15 percent to 30 percent greater than that of an average single-channel shopper.[2] Companies that “get it right” can enjoy larger profit margins and revenue growth.

Yet, the value of omnichannel retailing is not limited just to revenue generation and wallet share. A 2010 Harvard Business School paper identified five categories of potentially significant operational synergies as retailers move from disparate channel operations to optimized integration:[3]

1. **Cross-channel customer communication and promotion.** In an era when up to two-thirds of shoppers now use the Internet to research products and services, retailers can lift total brand conversion and up-sell.
2. **Leveraging cross-channel information and marketing research from one channel to improve decisions in other channels.** Online sales may yield information on the conversation rates between display and sales for various products, thus informing the product selection for key in-store display space.
3. **Cross-channel price comparisons.** Optimized integration suggests not a similarity of price across all channels, but the use of channels to highlight specific shopper opportunities and optimize turn. Special one-off buys may be best managed from a single distribution point, and thus be most profitably sold online; in-store operations might highlight the online one-off.
4. **Digitization.** The digitization of products such as operating manuals, bills, warranty documents, and registrations—and using the Internet to distribute to all channels—can reduce personnel and handling costs.
5. **Shared common physical assets and operations.** Spreading fixed costs across channels can create economies of scale and scope. For instance, databases that capture ratings and reviews, or enable recommendations, can be used online, in-store, in the catalog, and through the call center.

The Way Forward

We have created several questions that will help retailers create a customized four-step plan for reaping the benefits of omnichannel retailing:

1. **Define a senior management strategy.**
   - Is my brand positioned for success in a world that is rapidly being reshaped by the transitions in consumer technology, demographics, and competitive value propositions?
   - With a new definition of consumer segments, which ones are you targeting?
   - Which products, services, and experiences will appeal to these consumers?
2. **Focus on self-assessment and prioritization.**
   - Which critical capabilities are required to win in this new environment?
   - Are there opportunities to use new operating models or new technologies to achieve these capabilities?
   - How much time, effort, and risk are involved in achieving these new capabilities?
3. **Design the required operational processes and organization.**
   - What is the process within marketing for gaining an understanding of the customer and designing the customer experiences?
   - Which operations processes will allow me to execute on these customer experiences?
   - Which merchandising processes are required to create innovative and inspirational product/service solutions for the customer?

4. **Determine the required investments, and monitor progress for successful execution.**
   - What are the new performance metrics for individuals and organizations?
   - Which measurement capabilities are in place to monitor progress and respond to customers' needs?
   - What is our capacity to innovate and continuously evolve?

As you use the capability matrix and answer the questions listed in this paper, you will be well on your way to becoming an omnichannel retailer. While the journey won't be easy, we believe the benefits are worth the effort, as many other retailers are beginning to discover.

For more information about transforming your operations in an omnichannel world, please contact:

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Endnotes

1. Source: "The Promise of Multichannel Retailing," *McKinsey Quarterly,* October 2009.
2. Source: "Crafting Integrated Multi-Channel Retailing Strategies," Zhang, Irvin, Steenburgh, Farris, Kushwaha, and Weitz, Harvard Business School, January 2010.
3. Source: "Key Issues in Multi-Channel Customer Management: Current Knowledge and Future Directions," Scott A. Neslin and Venkatesh Shankar, *Journal of Interactive Marketing,* Volume 23, 2009.

More Information

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