INSIGHT

e-Commerce

AlixPartners
When it really matters.

Final-Mile Delivery

What Do Online Shoppers Want? And How Should Retailers and Their Logistics Partners Respond?

Free shipping. Faster delivery. More options. Online shoppers are stepping up their demands, but satisfying them could drain retailers' coffers. How retailers and their freight partners respond to the challenges—and opportunities—emerging in this changing landscape will spell the difference between success and failure in the future.

E-commerce is exploding in the United States, enjoying a compound annual growth rate of 17% from 2000 through 2015 and reaching $343 billion in revenue for 2015. In that same time frame, e-commerce has also constituted an ever-larger percentage of total retail sales, jumping from about 0.5% of the total in 2000 to almost 7% in 2015. By contrast, non-online commerce achieved a compound annual growth rate of just 3% during those 16 years.[1] In AlixPartners' recent consumer shipping survey, conducted in May 2016, roughly half of respondents said they order something online at least once every month. And findings reveal that consumers place an average of 15 orders online every year.

To transport all of those goods from warehouses and distribution centers to customers, retailers have to partner with transportation companies, including final-mile delivery companies and third-party-logistics (3PL) providers. Despite the emergence of alternative final-mile models such as ride-hailing services, the US ground-shipping market is still dominated by the Big Three—FedEx, UPS, and the United States Postal Service—which collectively claim a 90% share.[2]

US retailers and their traditional shipping partners have established a robust system for getting products to customers' doors. But our survey results indicate that the system may be about to change based on consumers' increasing demands and rising expectations. Those heightened requirements are putting new pressures on retailers—which must figure out ways to satisfy customers and still make a profit. Following is a closer look at what our survey revealed about the ways consumers' requirements are changing. We then consider how retailers and their shipping partners may have to respond if they are to safeguard their bottom lines and remain relevant to shoppers.

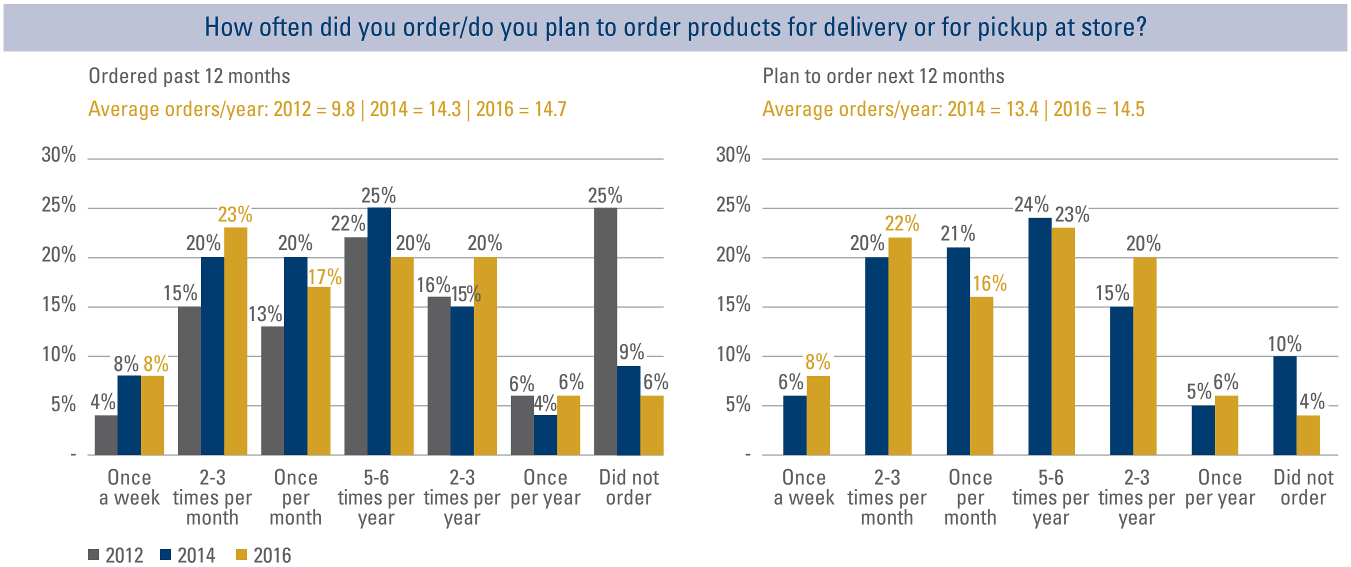
Online shoppers' expectations keep rising

Online shoppers keep setting the bar higher and higher. For one thing, they're buying more goods online (figure 1). Looking at the average number of online orders by respondents per year from 2012 to 2016, we found that the number jumped from 9.8 to 14.7 during that time frame. The biggest increase was in the 2-3-times-per-month category. Although 15% of survey respondents said they had placed online orders at that frequency in 2012, the rate shot to 23% in 2016.

Consumer respondents are also showing more interest in purchasing a wider range of products online, according to our study findings. Sure, certain products have been and remain the most popular among online shoppers—namely, clothing and shoes, books and media, gift cards and certificates, and small electronics and accessories. However, all product segments saw their online sales increase from 2014 to 2016 (figure 2). Even products that consumer respondents traditionally haven't been willing to buy online—like large electronics, large appliances, and furniture—could see greater online sales because barriers to ordering such items seem to have come down (figure 3). For instance, the percentage of survey respondents who were unwilling to purchase appliances online shrank from 38% in 2012 to just 12% in 2016.

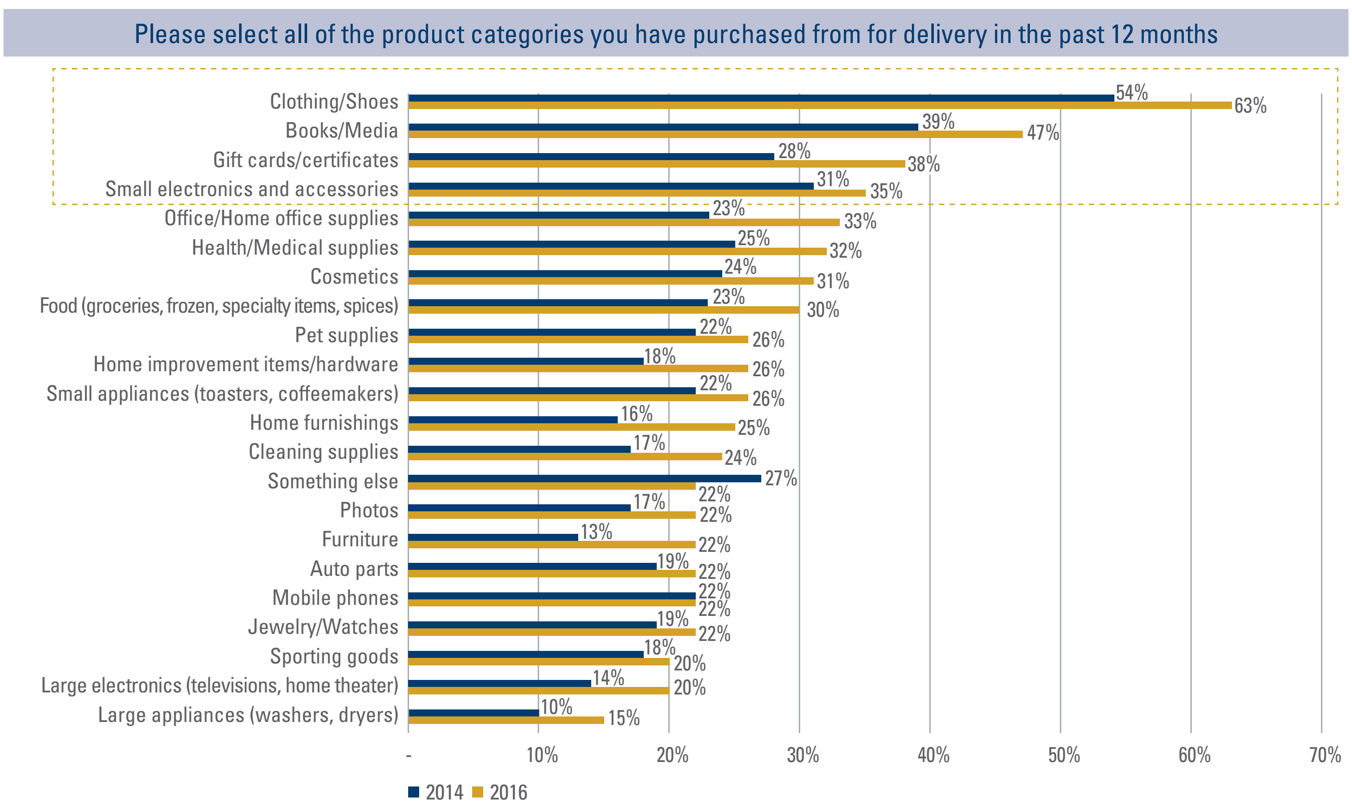
1 The Census Bureau of the Department of Commerce, "Quarterly E-Commerce Report."
2 AlixPartners analysis based upon company 10-K filings and annual reports, AlixPartners carrier database; USPS based upon parcel and package segments.

FIGURE 1: Online ordering is on the rise



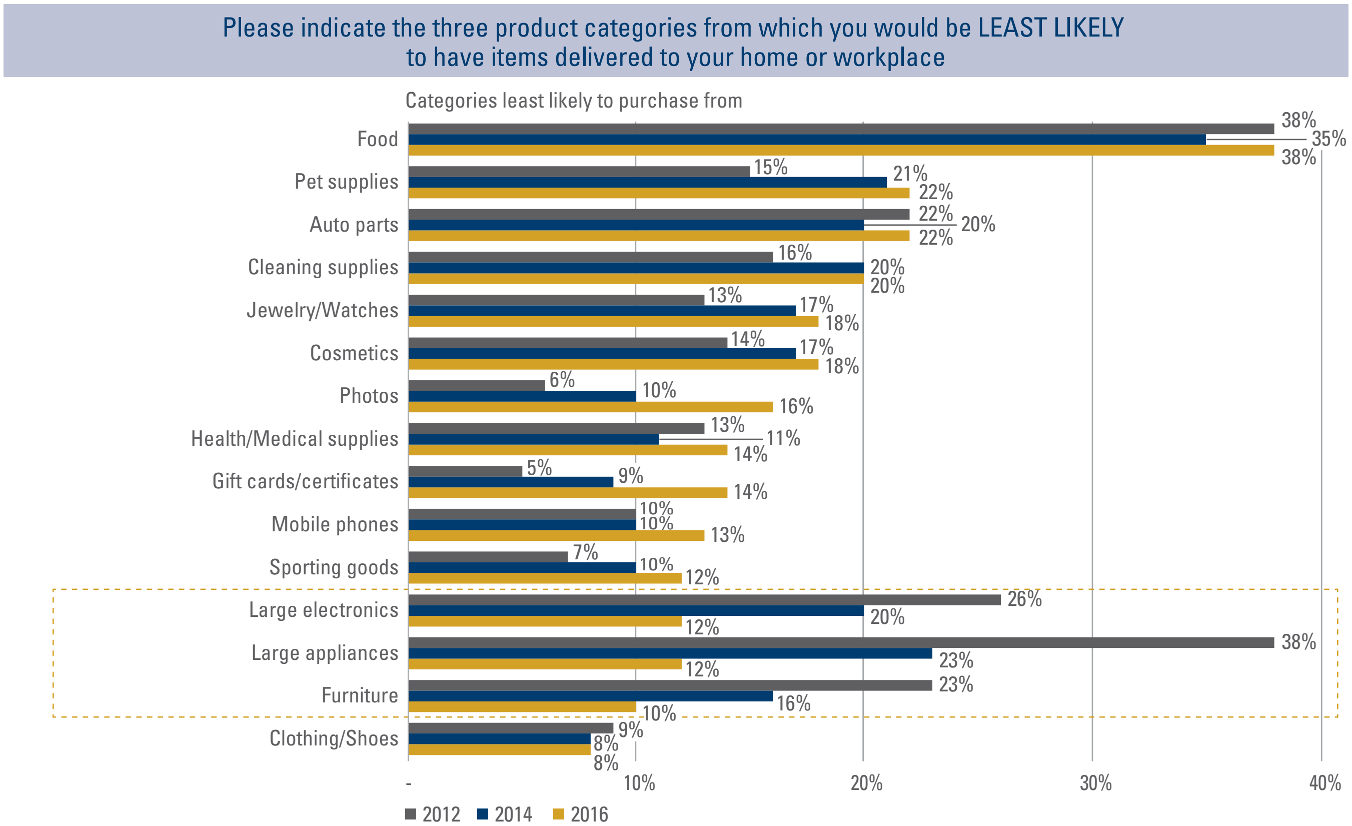
Source: AlixPartners' 2016 Consumer Shipping Survey

FIGURE 2: All product segments are seeing their online sales increase



Source: AlixPartners' 2016 Consumer Shipping Survey

FIGURE 3: Consumer respondents are more willing to have large items delivered



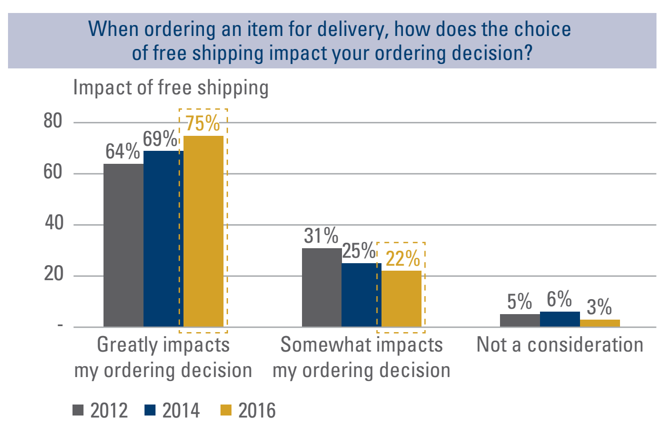
Source: AlixPartners' 2016 Consumer Shipping Survey
Note: Only top 15 categories were shown above

What's more, consumer respondents increasingly expect free delivery, which may be on its way to becoming table stakes in the retail game. In fact, 97% of our survey respondents said that the choice of free shipping affects their ordering decisions to some degree (figure 4). Among those who reported this, 75% said free shipping *greatly* impacts their ordering decisions. And that number is up from 64% in 2012.

Inspired by companies that provide next-day or even same-day shipping, consumer respondents today are also showing interest in faster-than-ever delivery to their doorsteps. Back in 2012, 74% of survey respondents said they were willing to wait five or more days to receive their items. In 2016, that number dropped to 60% (figure 5).

Availability of different shipping or delivery options also seems to make a difference in consumers' shopping choices. Among our survey respondents, 51% completely or mostly agreed that when shopping online, they browse products based on available shipping and delivery options. We asked participants about their attitudes and behaviors regarding a number of those options—and got some interesting answers.

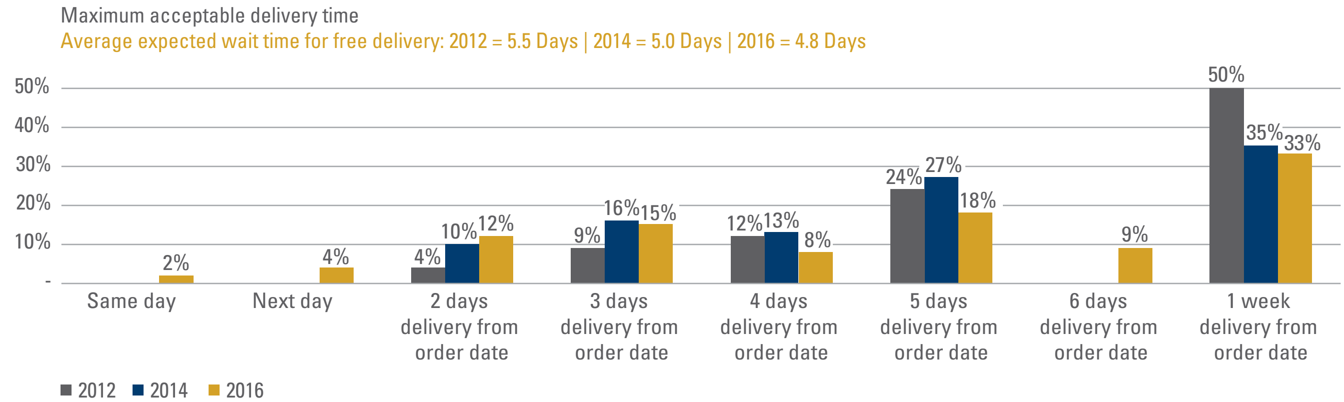
FIGURE 4: Free shipping has increasing appeal for consumer respondents



Source: AlixPartners' 2016 Consumer Shipping Survey

FIGURE 5: Consumer respondents want speedier delivery of goods

When you buy an item for delivery, what is the maximum delivery time you are willing to accept in order to receive free shipping?



Source: AlixPartners' 2016 Consumer Shipping Survey

Same-day delivery

In our study, 54% of participants said they don't request same-day delivery when shopping online—perhaps because of the higher shipping costs. Indeed, large percentages of respondents said they would not pay extra for same-day delivery. However, those most willing to pay more for same-day delivery said they would do so for large appliances or electronics or for other heavy or bulky items they've ordered. Moreover, among those willing to pay a fee for same-day delivery, choice of courier doesn't seem to matter to a significant, 41%, portion of them. Whether a product is delivered same day by a taxi, a ride-hailing service, or an independent part-time courier, these consumers said they consider that channel acceptable—as long as the retailer guarantees a product in perfect condition and delivery at the expected time.

In-store pickup

Most of the shoppers represented in our survey sample said they don't pick up online orders in retailers' brick-and-mortar stores at all, or they do so only occasionally. Sixty-six percent said they don't expect to use in-store pickup more in the future. Primary reasons for using the in-store pickup option included avoiding shipping costs and having an immediate need for the product.

Premium shipping service

As much as 37% of the consumers in our study said they're willing to pay for a premium, expedited-shipping service similar to Amazon Prime. But how *much* would they be willing to pay? Our respondents gave a range of answers to that question. The mean amount is $31.55 as an annual fee, though the bulk of respondents (60%) named fees ranging from less than $9.99 to $29.99.

Amazon Prime membership is on the rise, if our survey results are any indication. In 2014, 28% of respondents said they were members; in 2016, it's 36%. So far, the Amazon Prime membership offering seems to dominate, as only 14% of this year's respondents said they're members of other discounted-shipping or free-shipping services, such as ShopRunner.

In our 2014 and 2016 surveys, we also asked Amazon Prime members what they would do to get free delivery if given the choice of an increase in the annual fee or an increase in shipping transit time. In 2012, 41% said they would choose a rate increase over longer delivery times. In 2016, that number had dropped to 24%, suggesting that consumers are still very price sensitive to shipping costs.

Installation and assembly services

Since 2012, consumer respondents have become increasingly interested in services centered on installation or assembly of products ordered online and delivered to their doors. Such products include large appliances and electronics, furniture and home furnishings, home improvement and hardware items, toys, and health or medical supplies. But consumers seem *most* interested in paying for installation or assembly services when the products they've bought require lengthy or complex installation or assembly or when the items are especially large or heavy.

Next steps for retailers and logistics providers

Clearly, respondents' heightened interest in ordering online—along with their rising demands and expectations regarding delivery cost, speed, and quality—is reshaping the landscape that retailers and their shipping partners alike must navigate. Simply put, online shoppers now expect free delivery; and they want to receive their products faster than ever, even if they're unwilling to pay much—if anything—for speedy service.

In a bid to keep their customers satisfied, many retailers have jumped into the next-day- or same-day-shipping fray, further elevating customers' expectations. Potential alternative models for final-mile delivery, including the use of ride-hailing services, could give retailers fresh options for serving customers—but those models would also pose stiff competition for established logistics providers. Radical moves by some leading retailers—such as Amazon operating its own shipping fleet—could further challenge logistics providers.

How companies respond to these forces could spell the difference between success and failure in the future. For instance, as free shipping becomes table stakes in the retail game and as more and more companies feel compelled to offer ever-faster delivery, profit margins may erode if companies don't fully understand the true costs of providing such services. To protect their margins, they'll have to make smart choices about which products and which order sizes, delivered through which channels, would generate enough revenue to compensate for the higher costs incurred by offering free shipping and faster delivery. It's no secret that same-day delivery comes with serious cost challenges—such as reduced route density, reduced batching and pick density, higher costs in urban areas, and higher store labor picking costs—unless retailers have excess store labor capacity through their in-store service-level model. What's more, the revenues—and thus margin increases—that retailers might gain from offering same-day shipping are difficult to quantify. Providing same-day service as a knee-jerk reaction could trigger a dangerous pattern: one that already afflicted the office supply business when next-day delivery became standard in that industry. Major competitors began matching one another's services, thereby eliminating speed as a source of differentiation. Result: A higher cost structure for the entire industry.

Amazon has worked out a model whereby its technology service offerings subsidize customer-friendly delivery options and the overall retail business—which doesn't generate a profit, although it sells so much that Amazon can afford to run its own trucking fleet. But for retailers that don't fall into the tech-giant category, the path forward will likely look quite different.

Retailers will have to make changes on multiple fronts if they hope to surmount the new challenges they face while they also seize new opportunities. Likewise, logistics providers will have to craft the right strategies for managing new forms of competition. Following are several ideas that can help both types of businesses start navigating a landscape that's already shifting—and that's sure to change even more in the future.

Retailers

Customers' demands for faster delivery of goods they've ordered online will likely persist, if not grow even louder. To remain relevant, more and more retailers may understandably decide to offer next-day and same-day delivery. But because there's no guarantee that enhanced service levels would generate profits, retailers must carefully consider how to balance cost with service. They may also have to reconfigure their operating models. For instance, to rein in the cost of providing faster delivery services, retailers might have to move their inventories of fast-moving stock-keeping units closer to the points of consumption.

And because consumers don't seem to care who brings their items to their doorsteps, retailers can also consider exploring alternative shipping methods that may prove less expensive. However, they'll have to ensure that products arrive at the expected time and are in perfect condition, and they'll have to manage insurance and risk coverage. To do all that, they'll have to establish tight service-level agreements with their delivery partners and make sure that customers have ready access to tracking information.

In addition to adopting new approaches to their transportation partnerships, retailers may want to get more from their technology partners. For example, given that shipping options influence online shoppers' purchase decisions, retailers will likely need e-commerce Web site designs and fulfillment solutions that make it easy for customers to view and filter delivery methods and inventory locations.

When it comes to the in-store pickup option, although it still constitutes just a small link in the e-commerce supply chain, it can serve as a differentiator for savvy retailers. For one thing, it provides same-day, free service for customers with immediate need for the product in question. And it gives retailers an opportunity to generate additional revenue from shoppers who come to the store to get their product and then see other items they want to buy.

Logistics providers

Traditional logistics providers are facing new breeds of competitors, including Amazon, which constitutes many providers' biggest customer. Amazon has generated enough retail business to justify operating its own fleet of last-mile delivery vans. And that could eat into traditional players' business in high-density markets like major US cities. Additional competitors include the United States Postal Service, which offers Sunday delivery, and, possibly, on-demand providers in the form of ride-hailing services. Then there are the newly consolidated final-mile and regional parcel delivery companies, which now have the kind of scale and financial clout that their small predecessor businesses could never accumulate on their own. The entities born of these mergers and acquisitions could start going head-to-head with the established players.

To overcome the challenges posed by these changes, logistics companies should determine how to best capitalize on opportunities, also arising in the industry. Such opportunities vary across logistics subsectors (figure 6), and to seize them, providers should first decide which additional value-added services to offer and then focus on differentiating themselves from the competition. They'll likely have to partner with one or a few core customers at the inception of the new services. Proper training is critical because the last experience customers have with a retailer is the moment the delivery company interacts with them.

Conclusion: Embracing the challenge

Determining the best ways to respond to online shoppers' more-and-more-exacting delivery demands won't be easy for retailers. They'll have to take a cold-eyed look at the true, total costs of satisfying customers' rising expectations and then use the resulting analyses to manage painful trade-offs. Knee-jerk moves will come with high degrees of risk, and to safeguard their bottom lines, they'll have to turn over every stone in order to uncover fresh cost-saving and revenue-generating opportunities. They'll almost certainly have to reexamine their operating models and, possibly, even their business models.

Today's consumers' heightened requirements also have implications for the freight companies that support retailers. Freight businesses must understand the new kinds of competitors entering the arena. Some of the emergent rivals could also be major customers (think Amazon). Others are backed by the might of the US government or by scale and financial heft derived from consolidation. Whatever their origin, new players are stepping in to offer retailers a wider array of options for getting products to customers. And they're poised to reshape the logistics landscape.

Settling on the right responses to consumers' ever-increasing demands will amount to a major feat for both retailers and their transportation partners. But in a business environment that's only going to keep changing, neither type of company can afford to shy away from the effort.

FIGURE 6: Opportunities are arising in the logistics sector

SUBSECTOR	OPPORTUNITIES
3PL	• Growing demand for business-to-consumer capabilities close to urban centers could open up new revenue possibilities.
Real estate	• Ongoing declines in warehouse vacancies and the rising stock prices of real estate investment trusts with industrial holdings highlight market opportunities.[3]
Truckload	• Carriers focused on serving e-commerce retailers could gain volume in one of the few bright spots in the current economy.
Less than truckload	• Satisfying consumers' increasing demands for delivery of bulky items could generate new revenue, and carriers could extend such new offerings as expanded lift-gate service, inside delivery, and more value-added services like installation and assembly.
Last mile	• Volume growth has improved density, thereby reducing empty miles and transportation costs and presenting an opportunity to expand geographically if carriers can leverage assets—such as their fleets—across retailers.[4]

Source: AlixPartners

3 Cushman & Wakefield Research, 2015; "2015-2017 Industrial Real Estate Forecast: United States, Canada, & Mexico".
4 Inbound Logistics, July 2015, "2015 3PL Perspectives" by Joseph O'Reilly.

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