

Valitas Insights: Logistics & M&A – Adaptation and Transformation

Part 2: Logistics at the Heart of E-Commerce Proliferation

The Logistics industry was once a secondary focus for retailers, but has recently become the focal point for industry players looking to solidify the value proposition of their e-commerce operations. No longer just a tool used to move products from point A to point B, logistics offerings that are efficient and differentiated can be all the difference in today's ultra-competitive retail landscape.

With U.S. Thanksgiving last week, the holiday season is officially in full force, and the Retail and Logistics sectors are preparing accordingly. Best Buy's distribution centres are operating around the clock to fulfill online orders.¹ FedEx has hired 50,000 employees.² And, UPS is increasing shipping charges during the holiday season to smooth revenues and demand. Logistics companies are implementing these changes for the holiday season to ensure products are delivered to customers' doorsteps within a couple of days. Timely and last-mile deliveries were once considered luxuries that consumers have come to expect with every order nowadays.

Boston Consulting Group estimates that 7% of Canada's retail spending is attributable to e-commerce sales,³ and that this number will increase to 10% by 2020.⁴ At the centre of this fundamental shift from traditional brick and mortar retail to e-commerce is the Logistics industry, which stands to benefit tremendously from skyrocketing demand for home delivery. Consider that just two decades ago, the Logistics industry had minimal impact on business to consumer ("B2C") relations. Now, the respective logistics capabilities of industry participants are critical in determining the top players in the Retail industry. Generally, e-commerce players are employing three different logistics strategies to carve out a competitive advantage in their supply chains:

1. Acquisitions & Vertical Integration

Logistics providers and retail companies are expanding their fleets, through acquisitions and vertical integration, to cope with increasing demand from e-commerce orders. In December 2014, FedEx acquired GENCO Distribution Systems – a third-party logistics provider ("3PL") that specializes in return shipments – to expand its fleet. More recently, Walmart acquired Parcel in October 2017 to assist with same-day delivery in New York City. With increased shipping capacity, these retailers can deliver products faster and to more remote areas, which serves as an important value proposition while driving customer satisfaction and loyalty. Expanding logistics capabilities through acquisition is costly though, and this is pushing companies to explore alternative methods of logistics expansion.

¹ Star Tribune, *Best Buy's distribution centers work around the clock for holiday sprint*

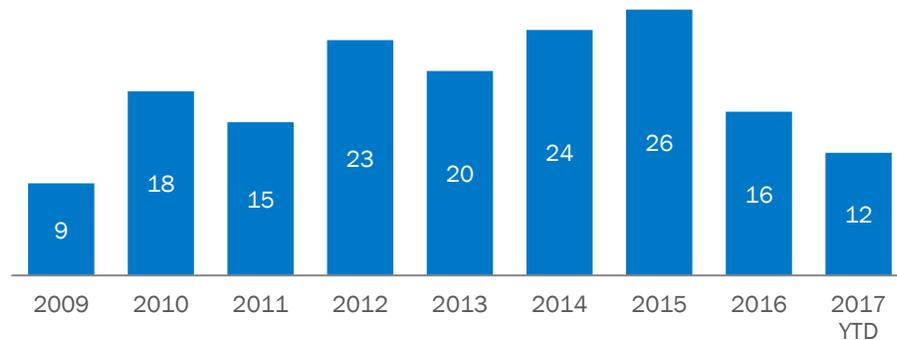
² Supply Chain Dive, *3PLs up the ante on peak season predictions despite higher rates*

³ Boston Consulting Group, *Will Canadian Retailers Meet Demand as E-Commerce Takes Off?*

⁴ Canadian POS, *E-Commerce To Account for 10% of Canadian Retail Sales by 2020*

Figure 1 demonstrates a steady appetite for acquisitions of 3PLs and supply chain management companies from 2013 to 2015, with a substantial drop-off in the last two years as companies look to less costly alternatives.

Figure 1: 3PL Acquisitions by Year⁵



2. In-House Development

Companies are developing their own internal strategies to adapt to a new era of e-commerce shopping and same-day delivery. Costco, for example, is converting some of its retail space into distribution centres to help fulfill same-day delivery on local e-commerce orders.⁶ Best Buy is utilizing software that optimizes the allocation of orders across its collection of distribution centres.⁷ Amazon is developing drone delivery,⁸ and Hudson's Bay introduced a fully automated distribution centre that can receive, package, and ship online orders in a swift 15 minutes.⁹ The dominant players in the Retail industry realize that gaining a competitive advantage in e-commerce is only attainable by optimizing their supply chains and logistics channels. Once considered a strategic afterthought, logistics is becoming an integral component to the competitive advantages of retail leaders.

3. Establish Partnerships

In January 2017, Jack Ma, Founder & Executive Chairman of Alibaba, stated that he is more interested in partnerships than acquisitions, because partnerships empower partners by giving them a greater sense of ownership over their work.¹⁰ This mentality, paired with a relatively lower cost of implementation, has opened the door for partnerships to proliferate the e-commerce space.

⁵ Capital IQ, November 28th, 2017

⁶ Fortune, *Costco's Battle Plan for the E-Commerce Wars*

⁷ Star Tribune, *Best Buy's distribution centers work around the clock for holiday sprint*

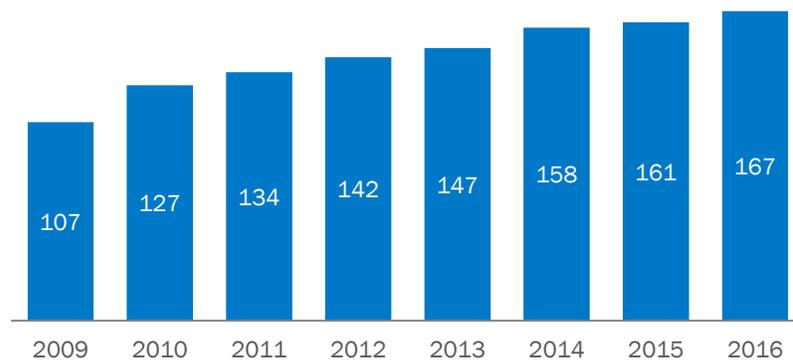
⁸ TD Daily, *Digital Trends Affecting the eComemrce Online Delivery Business*

⁹ BNN, *HBC CEO: Nobody will beat Hudson's Bay's e-commerce in Canada*

¹⁰ Business Insider, *Alibaba not interested in acquisitions, more interested n partnerships*

Martin Kelly, a Senior Advisor to Valitas, states that the growth of e-commerce is “is one of the driving forces behind the continued growth of the 3PL industry. This trend will continue because companies cannot keep up [with the shipping demands from e-commerce customers], so they hire a 3PL expert that can manage the change.” To compete with Amazon, Macy’s, Best Buy, and PetSmart all announced partnerships with Deliv in September 2017.¹¹ Deliv is a 3PL that focuses on providing same-day delivery. Similarly, last week Loblaw announced it was partnering with Instacart, a 3PL specializing in food delivery, to augment its e-commerce practice.¹² As Figure 2 demonstrates, 3PLs are increasingly in demand because retailers look to outsource logistics to assist in achieving same-day delivery and compete with Amazon’s logistics capabilities.

Figure 2: Revenue Among US 3PLs¹³



Another interesting byproduct of the e-commerce craze is the partnerships developing between companies operating in different industries that, up until recently, had no affiliation with each other. In September 2017, Walmart announced a partnership with August Home, a company that leverages smart technology for creating sophisticated home locks.¹⁴ This partnership was formed with the vision of rolling out an in-home service delivery. Also in September, Uber formally announced plans to enter the e-commerce delivery sector.¹⁵ If e-commerce can pave the way for a partnership between a retail store and a home security company, or a ride-hailing service and a grocery store, then it will be fascinating to see how other industries form partnerships to capitalize on an exploding e-commerce market.

Overall, the increasing popularity of e-commerce has stimulated players in the Retail market to implement three distinct strategies to achieve the same goal: online marketplace dominance. All three strategies hinge on logistics, whether that be leveraging larger fleets or

¹¹ Retail TouchPoints, *Macy’s, Best Buy, PetSmart Expand Same-Day Delivery Via Deliv Partnership*

¹² Financial Post, *Loblaw is closing 22 stores and launching home delivery*

¹³ A.T. Kearney, *Accelerating into Uncertainty*, pg. 29

¹⁴ TechCrunch, *Walmart partners with smart lock maker August to test in-home delivery of packages and groceries*

¹⁵ Recode, *Uber to Unveil Big E-Commerce Delivery Program With Retailers in the Fall*



proprietary technology. Therefore, mastering logistics is pivotal, which makes companies in the Logistics industry in high demand.

One difficulty persists in the e-commerce realm—reverse logistics, which is the collection of returned products from the consumer. Returns require product pick-up, sorting, transportation back to the distribution centre, and an assessment of whether it can be re-sold.¹⁶ This process is costly and time consuming.

Major retail and e-commerce players are deploying creative and innovative strategies to capitalize on the growing e-commerce market. As with any rapidly growing market, several questions remain unanswered: which strategy listed above will prove most successful? Will Amazon remain dominant in the industry? How will industry competitors adjust to the growing issue of reverse logistics? With retail and e-commerce subject to continuous disruption, it will be fascinating to see how the Logistics industry shapes and unites these two sectors in the years ahead.

¹⁶ DC Velocity, *Study: Reverse logistics still a puzzle for omnichannel retailers*