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ADVANTAGE

DIFFERENTIATING WITH LAST-MILE DELIVERY

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COVID-19 has altered many aspects of our daily lives. Nowhere is this more noticeable than in the soaring demand for last-mile delivery: In 2018, the last-mile delivery market in North America was estimated at \$31.25 billion. Prior to the pandemic, it was expected to grow to \$51 billion in 2022 — a projection that is probably conservative in light of current events.¹

Once regarded more as a “nice to have” capability, rather than an essential aspect to strategy for capturing market share, last-mile delivery is now a “must have” component of any business plan. Just a few months back, most customers were willing to pay a 12 percent premium for the convenience of last-mile delivery.² Today, bringing orders right up the customer’s doorstep is the only way for many retailers and restaurateurs to compete and satisfy demand.

It is more important than ever before for businesses to move fast in differentiating themselves in their last-mile capability. As necessary as it is to move quickly, it is also vital to make decisions that will stand them in good stead for the longer term.

THREE TRENDS INFLUENCING THE GROWTH OF LAST MILE DELIVERY

- 1. Shifting consumer expectations:** Pre-pandemic “I want it now” expectations of same-day and same-hour delivery are evolving into minimum basic services. Previously, 56 percent of online shoppers between the ages of 18 and 34 expected same-day delivery, while 61 percent of consumers were prepared to pay an additional charge for the convenience of same-day service.³ This trend will only accelerate in light of the COVID-19 outbreak, as customers perceive door-to-door delivery options to be a safer alternative.
- 2. Rapid technology advancement:** Rapid progress in delivery technologies, such as drones and artificial intelligence (AI)-enabled autonomous delivery vehicles, is driving down labor costs, reducing dependency on worker availability, and enabling round-the-clock delivery. The market for autonomous delivery vehicles alone is estimated to reach \$45 billion by 2027.⁴ Furthermore, delivery network carriers (DNCs) are constantly improving their logistics platforms to perform the most deliveries in the fewest number of miles. Each of these companies has an engineering department focused on making the batching and chaining of deliveries increasingly efficient.
- 3. New talent models:** The sharing economy is also providing answers to some of the inherent inefficiencies of last-mile delivery. As the novel coronavirus has demonstrated, scaling up capabilities fast is easier said than done: hiring drivers, purchasing vehicles, and building a delivery fleet represent a significant financial burden. DNCs can reduce the burden, but at a cost.

1 The Insight Partners. (2019). Last Mile Delivery Market — Global Analysis and Forecasts Report 2018-2027.

2 Retail Info Systems. (2019). Solving the Last-Mile Conundrum: Increased Consumer Expectations and Lower Profitability.

3 Invesp. (2019). The Importance of Same Day Delivery — Statistics and Trends.

4 PRNewswire. (2019). \$45 Billion Autonomous Last Mile Delivery Market — Global Outlook Report 2018-2027.

Retailers and restaurateurs are two sectors whose business models are enhanced by an effective last-mile delivery strategy. The convergence of trends and rise in last-mile options have created an opportunity to differentiate customer experience, streamline operations, capture value from insurance expenditures, and gain market share. However, participants in both sectors must carefully assess and balance their investments in specific delivery models and technologies, without misallocating precious capital. While these unprecedented times create significant challenges, opportunities exist for those able to deploy a successful last-mile delivery strategy. Across this ecosystem, different delivery models will suit different types of company — generalists, specialists, and underdogs (see Exhibit 1).

Exhibit 1. Last Mile Delivery Ecosystem

ARCHETYPE	<i>#TheGeneralist</i>	<i>#TheSpecialist</i>	<i>#TheUnderdog</i>
PROFILE OF THE COMPANY	Large retail constituents evaluating a range of potential solutions, leveraging efficiencies from economies of scale, and maximizing the utility of customer data	Traditional and specialty retailers and restaurant chains opting to ‘own the experience’ like the larger players but also weighing the cost and value of other options, striving for an optimal balance	Smaller retailers and independent restaurants building local scale through access to an enhanced delivery network, but also mindful of trade-offs and commensurate liabilities
INDUSTRY EXAMPLES	Mass-market e-commerce, big box retailers	Global fast-food companies, regional quick-service, specialty e-commerce	Regional grocers, ‘mom and pop’ restaurants, pop-up kitchens
LAST MILE DELIVERY MODELS	Owned and operated fleet	●	●
	Employee-owned vehicle	○	●
	Owned autonomous fleet	●	●
	Delivery network carrier (DNC)	●	●

Model suitability

● Attractive at scale of business ○ Some benefits, but outweighed by trade-offs — high risk / low reward

Owned and operated fleet	Employee-owned vehicle	Delivery network carrier (DNC)
In terms of liability and responsibility, the company has complete responsibility for the vehicle and driver — including running the motor-vehicle record (MVR), monitoring driver behavior, and any maintenance issues.	Generally, the company provides coverage in excess of the employee’s personal insurance, but otherwise responsibility is largely the same as that of the company-owned model if the employee is driving on behalf of and at the direction of the company.	Liability is usually transferred to the delivery network via a contract, limiting the responsibility of the company (for both drivers and vehicles) and the incurred costs to what are defined in the contract.

Deciding how best to pursue or blend delivery models requires careful consideration. In addition to the company's business strategy and scale considerations, each model must be evaluated across key workforce and risk-related dimensions.

A pure-play owned and operated fleet model is a traditional approach that represents a high degree of risk and cost for retailers and restaurants. Many of *#TheGeneralists* will deploy this model as they often have a strategic eye to the longer-term reward. The ability to fully own the customer experience, while using robust analytics capabilities to leverage key data (such as purchasing patterns, consumer sentiment, and demographic data), ultimately enables them to grow their core business. However, the costs associated with a driver's compensation, training, and benefits are the responsibility of the organization. Moreover, delivery drivers have limited career options if operating in a pure delivery capacity. That being the case, the business must deal with employee churn and recruiting costs. Last, the organization is more exposed to the risks of auto accident, workplace injury, and food-borne illness liabilities.

A Delivery Network Carrier (DNC) model on the other hand, enables retailers and restaurateurs to transfer a portion of the risks to one or more DNC providers. Employees of DNC providers often adopt a "gig" mindset, with the desire to engage in a transactional fashion, allowing on-demand, surge capacity at a fraction of the cost of owning a delivery fleet. As a result, a DNC model is often a more practical choice for some *#TheSpecialists* and *#TheUnderdogs*. A DNC can also help these participants access commissary kitchens, whereby dishes from multiple brands can be prepared under one roof and deliveries can be fulfilled. This asset-light model operators to break into new geographies/markets without the overhead of owning or leasing a brick-and-mortar location and owning a delivery fleet. That said, retailers and restaurateurs leveraging a DNC model will likely give up their ability to access and analyze valuable customer behavior data about how their products are ordered and received, potentially putting them at risk of being disintermediated by the DNC. Who ultimately "owns" the customer if a new intermediary that controls that experience is introduced?

The blending of these models requires retailers and restaurateurs to consider both external challenges as well as internal considerations.

Retailers and restaurateurs often deploy a "portfolio approach" to last-mile delivery options, ultimately settling somewhere along the spectrum of these models. Companies with the scale and ability to harness insights from data are likely to in-source and invest substantively in their own last mile solutions, while smaller organizations will be more likely to partner with DNCs to handle delivery. Mergers-and-acquisitions (M&A) activity is also an option for large corporations to obtain last-mile delivery capacity. A prime example of this is the retail giant Target's purchase of Shipt. There are also instances where large delivery operations may purchase a retailer, as happened when Amazon acquired of Whole Foods Markets. These opportunities are increasingly likely to emerge as the current pandemic progresses.

The blending of these models requires retailers and restaurateurs to consider both external challenges (detailed on the following page), as well as the following internal considerations:

Demand planning: How will demand patterns change over time, especially in the current and post-pandemic world?

Customer experience: Can I create a differentiated experience by including last-mile delivery in my strategy?

Logistics and operations: Are there economies of scale to be had from leveraging existing infrastructure, technology, and logistics?

Data-driven insights: How valuable is the underlying, anonymized order-preference data of this business? What will it cost to use this data in actionable ways?

Risk management: Are there liability and/or workers' compensation issues unique to the current and future operating environment? What kinds of loss controls should be in place? What health considerations will be required to protect my workforce and customers following COVID-19?

Delivery model choices may seem obvious. However, given the evolving business landscape — market uncertainty created by the COVID-19 pandemic, rapidly maturing technologies, and increasing customer expectations — a seemingly appropriate solution today may not be the right choice tomorrow.

THREE MACRO TRENDS THAT WILL FURTHER INFLUENCE LAST-MILE DELIVERY

When assessing future last-mile delivery models, organizations must factor in longer-term trends that are likely to unfold in a post-pandemic world — evolving workforce and regulatory considerations, a migration to autonomous mobility modes, and the impacts of climate change:

- 1. Cost pressure due to labor force protection.** Contractors will weigh their own health risks when deciding whether they can safely and profitably participate in the gig economy. As governments move toward protecting gig workers, the emerging regulatory environment could include an effective substitute for worker benefits, commission caps for delivery network companies, and other stipulations that will increase cost pressures. The passage of California's AB-5 legislation regulating gig worker employment, and the recent related legal action against Uber and Lyft, demonstrate that this trend is already cutting into margins.
- 2. Autonomy is closer than some think.** Moving product from door to door has proven to be a more complicated logistical challenge than from warehouse to warehouse. Globally, about 40 percent of overall logistics costs are associated with the last mile.¹ This dynamic is a primary driver of migration to autonomous forms of transportation even today. Prior to the outbreak of COVID-19, the development of aerial delivery drones and ground delivery vehicles for autonomous last-mile delivery was expected to reach \$75.65 billion by 2030.² This estimate may prove conservative. While people may be moving less in the future, packages and restaurant take-out undoubtedly still will. Even today, industry players are already looking to staff key autonomy leadership roles in their organizations.
- 3. Climate threats may also impact last-mile operating dynamics in the future.** Pragmatic, environmentally responsible moves should be considered; otherwise, last-mile players stand to risk not just business and operational disruption, but also public backlash and media scrutiny. The foreseeable increase in delivery vehicles on the roads will emit an additional six million tons of carbon dioxide, putting added pressure on existing decarbonization targets.³ The extent to which last-mile players can migrate to more environmentally friendly modes of conveyance, such as the use of micromobility solutions in dense urban areas and the use of autonomous electronic vehicles more broadly, will play a key role in mitigating this risk.

Looking ahead, beyond COVID-19, last-mile offerings will continue to be a critical differentiator. The trends highlighted above, coupled with consumer demand for shorter delivery time and the need for more technologically advanced delivery vehicles, will continue to drive the development of innovative solutions.

1 Frost & Sullivan. (2018). Urban Logistics Opportunities — Last-Mile Innovation, 2018.

2 Allied Analytics LLP. (2019). Autonomous Last Mile Delivery Market by Application, Solution, Range and Vehicle Type: Global Opportunity Analysis and Industry Forecast, 2021-2030.

3 WEF. (2020). Future of the Last Mile Ecosystem.

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