In the fight for market share, retailers are now optimizing every facet of their operations to gain competitive advantage. Along the way, customer expectations have been raised to new levels. Vast inventory selections, expedited delivery and lower pricing are no longer capabilities reserved for the retail elite; they are the capabilities that customers expect from every retailer with which they do business. Those that can’t perform them well risk both relevance and revenues.

At the epicenter of the struggle between customer demands and profitability lies the fulfillment process. In a survey recently conducted by Retail Systems Research, retailers cited “cost effective shipping and fulfillment” as one of their top three operational challenges, and “improving fulfillment operations” as the second largest opportunity to overcome a long list of sales and marketing struggles (Source: Retail Systems Research, The Multi-Channel Retailer’s Reality in a Post-Amazon World, November 2012).

Today’s suppliers are feeling the brunt of this fierce marketplace, especially as a growing number of retailers are turning to new, complex fulfillment models to improve sales, operations and customer satisfaction. To fulfill customer orders with the speed and efficiency demanded by today’s online shoppers, many retailers are turning to drop shipping, also known as supplier direct fulfillment (SDF), or vendor direct fulfillment (VDF). This model requires suppliers to ship products directly to the consumer as well as carry the cost of inventory for longer periods of time.

Using drop shipping, a retailer can test new product categories and customer segments without incurring the financing, service and storage cost risks typically associated with growth.
While retailers have embraced drop shipping enthusiastically, suppliers have been more cautious. In many ways, drop shipping has eroded suppliers’ control across the supply chain while simultaneously increasing cost and resource burden. In an effort to create a seamless and branded experience for consumers, retailers require suppliers to follow complex routing guides (or vendor compliance manuals) that spell out the retailer’s unique shipping processes. A single routing guide may include 50 to 150 business rules, all of which must be followed without exception. Compound this with the fact that more retailers are opting for drop shipping, and it’s easy to see how even the most sophisticated supplier operations struggle with compliance.

Yet, drop shipping isn’t a fad; it’s a viable logistics strategy adopted by the world’s most successful retailers and shows no signs of slowing down. In fact, suppliers that demonstrate advanced drop shipping capabilities have become increasingly attractive to large retailers. If retail suppliers want to prime their operations for higher revenues, they must learn how to leverage drop shipping as a growth driver rather than detractor.

Frank Poore, founder and CEO of CommerceHub®, believes the future of retail lies in drop shipping. He comments: “The train has left the station. Drop shipping is the reality and the future of large retail. For retailers, it’s not a matter of ‘should we?’ It’s a matter of ‘how can we do it better than anyone else?’ It’s priority number one.”

CommerceHub® is the industry’s leading provider of drop ship fulfillment for multi-channel merchants. With 12,000+ retailer-supplier connections and many of the Top 25 retailers using its platform to process more than 34 million orders in 2012, CommerceHub’s visibility into the impact of drop shipping on the supplier-retailer relationships is unique.

According to Poore, the highly competitive retail environment is forcing retailers to improve their ability to compete in three critical areas: product assortment, shipment speed and a seamlessly branded customer experience. Suppliers that can strategically improve retailers’ performance in these areas will undoubtedly have an advantage in the marketplace.

“The world is changing and so are customer expectations... customers are evolving from stores or websites to networks.”

Jerry Storch, CEO, Toys R Us
Defining the Perils and Possibilities of Drop Shipping

Until recently, few suppliers have viewed drop shipping as a strategic business driver. Instead, it has been perceived as cumbersome and costly. But, as more retailers adopt drop shipping, suppliers must find ways to transform the operational and compliance challenges into opportunity. When executed consistently well, drop shipping can help suppliers:

- **Differentiate in commoditized product categories.** The Wall Street Journal Online once reported that some highly regarded retailers such as Walmart select as few as two percent of the suppliers that apply to do business with them (Source: The Wall Street Journal Online, *The Long Road to Walmart Shelves*). Therefore, it’s no surprise that suppliers (especially those in highly commoditized product categories) are challenged to find ways to differentiate their offerings from competitors. Drop shipping presents an opportunity for these organizations to accomplish this goal while adding value to retailer operations.

- **Uncover new sales opportunities and channels.** Suppliers that demonstrate best-in-class drop shipping capabilities will be well positioned to grow their current retail accounts, as well as secure new retail clients. Additionally, because drop shipping requires suppliers to become fully entrenched in the consumer shipping process, if desired, suppliers can use that knowledge to open the door to direct-to-consumer sales channels.

- **Develop more profitable retailer relationships.** New sales opportunities are just one way suppliers can monetize drop shipping. Those suppliers that can bring efficiency and consistency to the way they execute drop shipping can protect and increase profit margins, while decreasing operational costs. This is a critical part of the drop shipping/supplier value proposition as market forces continue to shrink profit margins across virtually every product category.

“The promise of so many new digital offerings is exciting but only if there’s product to support it. That other half of ‘buy anywhere’ is ‘fulfill anywhere’... so customers can ‘shop across channels enjoyably.’”

Jordan Speer, Editor in Chief, Apparel Magazine
Close the information gap between consumer and supplier operations. Traditionally, suppliers have had little insight into consumer preferences, trends and feedback. Drop shipping can bridge this information gap by giving suppliers greater access to valuable end-consumer data, such as product and geographic trends. This data can help suppliers improve inventory selection, forecasting and customer marketing operations.

While these benefits can have a tremendous impact on supplier success, they aren’t without challenge. In order to realize the full potential of the drop shipping opportunity, suppliers must mitigate several operational and financial risks, including:

- **Higher inventory service and storage costs.** Before drop shipping, suppliers would ship all or most orders as bulk directly to a retail store or distribution center. The cost of storing, sorting, picking and stocking was transferred to the retailer. With drop shipping, however, the cost (and risk) is pushed back upstream to the supplier. The supplier is now responsible for executing the activities required to fulfill higher volumes of single unit orders.

- **Complex routing guides and compliance pressures.** When a retailer adopts the drop shipping model, they aren’t just outsourcing fulfillment; they’re outsourcing a large portion of the consumer satisfaction process. As such, routing guides have become more rigid and complex (see related UPS white paper, “Routing Guide Strategies: A Road Map to Driving Successful Retailer Relationships” at ups.com/routingguides). Suppliers must be compliant with every retailer requirement including carrier selection, labeling and packaging, advanced shipping notices (ASNs), delivery notifications, returns process instructions and inserts. The more retailers a supplier serves, the higher the chance of errors and lower vendor compliance.

- **Higher technological and worker demands.** Suppliers’ technological and worker skills are typically geared towards bulk shipment processing. Existing manifesting technologies must be reconfigured to provide visibility into single shipments, as well as communicate shipment data to both the retailer and consumer. In most cases, this requires outside (and costly) professional services or the purchase of new supply chain IT functionality. In addition to higher IT costs, suppliers must also retrain workers. Most have never had to do more than re-palletize and ship inventory to retailers. In a drop shipping environment, workers now have to complete a full spectrum of pick, pack and ship activities.

Learn more about the role of routing guides by downloading the UPS white paper, “Routing Guide Strategies: A Road Map to Driving Successful Retailer Relationships” at ups.com/routingguides.
• **Branding consistency and cohesiveness.** For drop shipping to be effective, it must be invisible to the consumer. That means suppliers have to follow strict branding guidelines set forth by retailers. From the branded label that goes on the outside of the box, to the way products are packaged, to the promotional and returns processing inserts, suppliers are responsible for carrying the retail brand “over the finish line” and creating a seamless experience for the consumer.

### How to Leverage Drop Shipping for Business Growth

Suppliers face a daunting decision. They can either embrace drop shipping as a new business normal – or risk revenues. Those that invest in best-in-class drop shipping capabilities are ahead of the curve and have a clear market advantage.

There are five ways suppliers can optimize their drop shipping capabilities to grow their business:

**Have a direct upload from each retailer’s purchase order program into the supplier’s shipping manifest system.**

In the drop shipping model, the supplier’s responsibility extends well beyond shipping. The experience the supplier creates for the end consumer can have a direct impact on consumer satisfaction. Whereas a simple error may have once created a glitch in a retailer’s operations, a supplier’s error in an drop shipping environment can cost a retailer a consumer and the total lifetime value they bring to the table.

Nowhere is the drop shipping process more prone to errors than in the transfer of specifics between the retailer’s purchase order program and the supplier’s shipping manifest system. This information typically includes item, quantity, order date, ship to address, ship date, expected delivery date, customer name and contact information, shipping service, label and packaging requirements, and notification requirements. The large volume of data greatly increases the chance for supplier errors, particularly in cases where the pick, pack and ship process is new to the supplier.

**WorldShip®, ConnectShip® Warehouse and many other UPS Ready® vendor systems integrate retailer purchase order data directly into the supplier’s manifest and labeling process through batch upload. These systems also feature batch export capabilities that allow suppliers to confirm order completion so the billing process can begin. Within WorldShip’s standard tools, and customizable through ConnectShip, suppliers can build templates that create and assign business rules to retail customers to improve both accuracy and compliance.**
To mitigate this risk, suppliers need to invest in direct, batch upload capabilities that automatically transfer data and business rules from the retailer’s purchase order program to their shipping manifest system. By integrating this functionality into their logistics technology infrastructure, suppliers can decrease the cost of compliance and improve vendor scorecard performance.

**Provide integrated order visibility directly to retailers and end-consumers.**

Consumers have grown to expect visibility into the fulfillment and shipping process. According to a study commissioned by UPS and conducted by comScore, 75 percent of online shoppers think it’s important for retailers to offer tracking information, while 24 percent of those who abandoned a cart said an estimated delivery date wasn’t provided at checkout (Source: comScore, *Online Shopping Customer Experience Study, May 2012*, commissioned by UPS). Notifications with tracking status data, as well as other information, such as those delivered through text or email, allow consumers to confirm a series of milestones in the fulfillment process – from order processing and product availability to estimated shipment and delivery dates.

With drop shipping, however, the burden of visibility is now shifted to the supplier. For many retailers, this introduces layer of opacity within the consumer notification process. A retailer must confirm order receipt, availability, shipping and delivery with the supplier before transferring this knowledge to the consumer. It’s an additional step that wastes both time and cost – as well as adds risk – all while doing little to meet consumers’ demands for real-time information. This presents an opportunity for those suppliers that can automate, simplify and improve order visibility for end-consumers. By automatically generating and delivering notifications directly to the consumer and/or retailer, and generating this information in a way that can be easily shared between disparate order/fulfillment systems, suppliers can improve the customer experience and enhance their relationships with retailers.

**Align supplier fulfillment operations with retailers’ delivery commitments.**

For the last decade, retailers have been streamlining e-tail operations to offer shorter click-to-delivery times. The challenge is that a retailer’s delivery time frame commitment can only be as short as the longest order fulfillment timeframe, regardless of whether the order is being shipped from a distribution center or directly from the supplier.
It’s imperative that suppliers align their fulfillment operations with the delivery commitments of their retail customers. Retailers are far more inclined to find a new supplier than they are to change their customer delivery commitments. Therefore, suppliers have little choice but to invest in tools that will enable them to fulfill delivery schedule requirements, regardless of the cost and resource burden.

To meet retailers’ commitments, suppliers must expedite fulfillment processing through the integration of purchase order and shipping manifest systems as previously described. Additionally, the use of automatic validation tools that verify delivery addresses, email addresses, retailer billing information and service selection will reduce the amount of time required to manually confirm this data as well as improve accuracy. Lastly, suppliers must systematically weed out operational redundancies and risks across the fulfillment process. This includes streamlining carrier selection, integrating/reducing the number of shipping systems, and engineering labor optimization at every juncture.

**Support and create a seamless brand experience.**

As described earlier, today’s drop shipping-enabled suppliers are responsible for managing a large portion of a retailer’s customer experience. However, this responsibility goes well beyond slapping a logo on a packaging slip. Suppliers must entrench themselves in the retailer’s brand. This involves understanding what the brand means to the end consumer and how it can be improved by the logistics that drives drop shipping. For example, how will packaging, labeling, carton inserts and order communications reflect the retailer’s brand? Does the brand need to appear on the label or within the order confirmation communications? Suppliers that can proactively offer branding best practices and capabilities to their retail customers increase the chance of being viewed as a strategic business partner.

**WorldShip, ConnectShip and UPS Ready vendor systems are engineered to expedite the fulfillment process.** For example, WorldShip automatically validates address and bill-to information to enforce delivery commitments and accuracy. Additionally, these solutions are designed to eliminate operational redundancies, such as maintaining a separate printing process for packing slips and packaging labels. UPS’s tools make it easy to print a second label for each order that contains the packing slip information. Furthermore, because UPS already has relationships with 24 of the top 25 retailers, most suppliers can easily consolidate pickup for their UPS retailer-routed and prepaid shipments.

**UPS has several options for suppliers to create the optimal return strategy based on the desired customer experience.** The UPS Print Return Label gives suppliers the option to quickly print a return label using WorldShip or other UPS shipping solutions and include it in the outbound shipment. Shipments with a Print Return Label can be tendered to virtually any UPS location, or through UPS On-Call Pickup.
Smother, more cost-efficient returns process for customer and retailer.

The returns process plays a critical (and growing) role in the retail customer experience and satisfaction. comScore reports that 59 percent of online shoppers have or would recommend a retailer based on an easy returns and exchanges experience. However, only 65 percent of online shoppers are satisfied with this aspect of online shopping (Source: comScore, Online Shopping Customer Experience Study, May 2012, commissioned by UPS).

With a commitment to improving customer satisfaction, retailers have become laser-focused on refining the reverse logistics value chain. Suppliers have an opportunity to add value to this process—whether it’s providing additional packing slip inserts as return label options grow or reconciling customer addresses and order types with multiple return locations or service options. Those suppliers that can augment and/or streamline retailers’ returns operations can deliver a powerful impact to customer satisfaction and supplier performance.

From Risk to Reward to Strategic Partner

As retailers attempt to turn drop shipping into a competitive advantage, the opportunity for suppliers is tremendous. Increasingly, retailers are requiring advanced drop ship capabilities from their suppliers that go well beyond speed of shipment. Retailers are demanding higher visibility into shipment delivery, seamless customer notifications, branded labeling and returns processing capabilities.

CommerceHub’s Frank Poore adds: “The upside of drop shipping is suppliers that invest in advanced capabilities have a huge growth opportunity. The downside is it’s becoming a barrier to entry for large retail business. If you’re a supplier and you’re not thinking about how you can add value to the drop ship process, the survival of your business may be on the line.”

By transferring fulfillment responsibilities, retailers have given suppliers an unprecedented opportunity to become strategic, high-value business partners. Those suppliers that invest in advanced drop shipping capabilities, technologies and logistics partnerships are investing in the future of retail, not to mention the long-term success of their operations.

By making these investments ahead of the curve, they will be rewarded with more profitable retailer relationships, new sales opportunities, and lower operational cost and risk. In a time when most suppliers struggle with category commoditization and shrinking profit margins, this opportunity isn’t a luxury—it’s a genuine opportunity to grow and secure their business.