Overview

Drop Shipping (also called "Endless Aisle", "Virtual Supply Chain", etc.) can be a very efficient and financially attractive way of expanding a retailer's reach into existing or new markets. By expanding the number of products and vendors you work with, you can provide a wider assortment than you would normally have when restricted by physical inventory.

With that said, it can also be overwhelming if not handled correctly. While you are increasing margins by reducing warehouse and transportation costs, you also run the risk of reducing control over the customer experience.   Retailers who have successfully executed on a drop ship order fulfillment model have taken the time to clearly identify what they want to control and set clear expectations for their vendor community.

Because of the distributed nature of the drop shipping model, you need to consider the impact on both your systems and vendor relationships. Using drop shipping, you will need to have a much tighter relationship with your vendors and their systems than you would in a traditional supply chain. For example:

- Instead of integrating with a single repository of inventory, each vendor will be a source of inventory, so you will need up to date visibility between your organization and theirs.
- To ensure good customer service, your vendors will need to be able to accept electronic orders and provide timely status updates directly to your systems.
- Because your e-commerce website will now have products from multiple vendors and locations, you will need to be able to take a "consumer" order and break it up into multiple "vendor" orders and in turn, consolidate order status updates back into a single consumer view.

DropShip Commerce's products are designed to specifically address these challenges by helping augment your current systems to support this complex fulfillment model. Because of this, we have extensive experience in helping retail organizations prepare for drop shipping as well. Below are a number of things to consider when planning a new drop shipping program.

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Vendor On-Boarding

Identifying and on-boarding vendors for a drop ship or endless aisle program is different than doing so for a traditional order fulfillment method. Because there is no "commit to buy", the bar for selecting participating vendors can be lower. In turn though, this lack of financial incentive can affect the willingness of the vendor to spend time and money to meet your compliance needs. Finally, because of the distributed nature of drop shipping, electronic data exchange cannot be optional for the vendor. Below are a list of factors that need to be considered when doing a vendor selection:

- **Vendor Logistics Capabilities**: When selecting a vendor to participate in a drop shipping initiative, it is important to ensure that the vendor can do single-item fulfillment. The ability for the vendor to select individual items (pick and pack) in their warehouse or fulfillment center is a pre-requisite for drop shipping. A good way to evaluate a vendor's ability is to see if they do direct to consumer fulfillment via their own e-commerce website.   Many vendors underestimate the costs of switching to a single item fulfillment model, so be cautious of vendors who promise to make the switch on your behalf.

- **Technology Options**: Because you will be asking vendors to commit time and resources to your drop shipping program, while you are not committing to a specific revenue number, it is important to minimize the technical excuses for not participating. This means providing multiple options for vendors to exchange data with you at no or little cost to the vendor. You need to be able to support a vendor with very little technical capabilities while also being able to accommodate a trading partner who may have a mature and robust e-commerce infrastructure. Optimally, you will be able to provide vendors the choice of:
    - A self-service, manual Vendor Portal
    - A non-integrated batch process (spreadsheet exchange)
    - An automated, file based integration option

- **Consistent Messaging:** It is important that whatever message you create to encourage vendors to participate in your drop shipping program is maintain consistently through out the organization. This will ensure that not only your organization will understand the importance of the program for your business, but it will also impact the adoption by your vendors. If a vendor is receiving mixed messages about why and how they are to do business with you, it will slow down vendor on-boarding.   In addition, if there is a misunderstanding of expectations it can ultimately adversely affect your end-customer experience.

- **Using drop shipping as a way to "test" new products and vendors:** One way of enticing vendors to participate in your drop ship program is to use it as a method for evaluating new vendors and products. If there is a path from being a drop ship vendor to a stocking vendor, many of your trading partners will invest time and resources they might not otherwise be willing to spend initially.

Product Assortment

With all e-commerce initiatives, there is a heavy emphasis on creating, gathering and organizing robust product data. Because you no longer can rely on the customer touching and feeling the product, e-commerce product data needs to replace this experience.   You need to consider what product data you need on your website, where it is going to be created, and how it is going to be updated. To help you determine your product strategy, you should consider the following:

- **Determine the scope of products you want:** The advantage of moving to a drop ship fulfillment model is that you are no longer constrained by traditional inventory costs. You can "carry" as many products as you want without the limitations of warehouse or shelf space. When asking your vendors for product data, the difference in effort between providing one item and all of their items is usually very little.   By having all of a vendor's product data, you can then make assortment choices more dynamically.   The only reason to not request a robust product feed is if you do not have a system that allows you to aggregate, store and view this information easily.

- **Identify the product data you *need*** : Because more data is required in the e-commerce world, it is important to identify what information is required and what is optional. Non-traditional information like descriptive marketing copy and digital assets (pictures, user guides, movies, etc) increase the amount of data that you need to accommodate. Because of these factors, it is important to identify how much of this data you want to require from your vendors and how much you want to create yourself.   There are three strategies for product acquisition:
  - *Vendor Product Data*: This is the fastest and easiest option. To accelerate adding new products, you need to make it easy for your vendors to provide this information. You need to have the ability to accept product data in multiple formats as well as from multiple sources.
  - *Retailer Product Data*: By creating all of the product data yourself, you will ensure that you have everything your need at the level of quality that you want. Not only is this option expensive, it can be difficult to do in a drop shipping model because of the "inventory-less" nature of drop shipping you often times will not have access to the physical products.
  - *Hybrid Product Data*: This is the most common product data strategy. You gather as much product data from your vendors as they are capable of and then augment it with data that you create.

Inventory Management

Drop shipping does not eliminate inventory, instead it eliminates the need for you to physically manage the inventory. Just as you need systems and processes to have visibility into the physical inventory in your stores and distribution centers, you still need to have visibility into your non-physical or drop ship inventory. In essence, you still have inventory, it is simply distributed across many different vendors and locations. Because of this, you should expect to manage your "virtual" inventory with systems and processes as well. The following are things to consider when developing these systems and processes:

- **Committed Inventory:** While you are no longer physically managing your inventory when you drop ship, you still need to know how much product is available for you to sell. Instead of buying and "stocking" product, you now need to work with your vendors to ensure they are committing inventory to you. This is done during the time of vendor onboarding and is usually negotiated between the buyer and the vendor. By establishing a "committed" inventory level, you and the vendor are estimating what potential demand may be for a product. As your relationship matures and you have real sales data, the amount of inventory committed to your drop ship program may change. The obvious goal of getting an inventory commitment should be to ensure that you do not face an out-of-stock situation. In reality, it is also a way of helping the vendor understand your level of commitment to the relationship – without making an actual financial commitment.

- **Inventory "Freshness":** Given a choice, most retailers would like a real-time data feed from each of their vendors inventory management systems to ensure they have the very latest inventory levels through out their virtual supply chain. This is an unrealistic option though. With a few exceptions (proven high-turn products) **a once a day inventory update** is more than "fresh" enough for most retailers.   While the promise more data is more accurate data, it can actually cause a number of problems that result in the exact opposite. If it is perceived by your vendors to be a burden, you will find that they will either not provide updates or they will provide inaccurate updates. By increasing the frequency of updates, you are asking either their systems or staff to do more work on your behalf without an obvious perceived benefit.   Also, if the products aren't selling at a high volume, you are taxing your systems to process a lot of unchanging data for no reason.

- **Drop ship inventory vs Stocked inventory:** In most cases, a retailer's e-commerce site contains products that the retailer will fulfill from inventory and products that will be drop shipped directly from the vendor. You will need to have plan for managing both inventory status feeds for both products, as well as a fulfillment strategy.

Order Management

Because you will be dealing with consumer-based orders (via your e-commerce site), there are a number of new issues to consider when leveraging a drop shipping fulfillment model.

- **Converting a Consumer Order into a Vendor Order:** Unlike a traditional fulfillment order where there is a one to one relationship between the order and the vendor, a consumer order will often contain items from multiple vendors in a single shopping cart. You will need to be able to:
    - o   Associate vendors with products
    - o   Split the Consumer order into one or more vendor orders (based on products)
    - o   Create an out-bound, electronic vendor order
    - o   Accept inbound order status updates from the vendors
    - o   Aggregate order status updates from multiple vendors back into a single consumer order update

    In addition to a consumer order having products from multiple vendors, it may also contain a mixture of drop ship and stocked products. Your distribution center will also need to be able to act as a "vendor" by accepting and updating the consumer order status.

- **"Fill or Kill" vs. Backordered:** Most consumer orders are going to contain a small number of products per vendor (often times a single item), you will need to establish rules on what a vendor does when they are not able to immediately fulfill the order. Often times, a retailer will operate their drop ship program under a "Fill or Kill" model. This means that if the vendor is unable to fulfill the order, the order is cancelled vs. going into a back order status.

- **Single Shipment vs. Multiple Shipments:** You will need to establish rules as to whether your customers receive their orders in a single shipment vs. multiple shipments. If you chose a single shipment methodology, drop shipping may not be possible in all cases. If a consumer order contains items from multiple drop ship vendors, they will need to each create a separate shipment for the consumer.

- **Order Visibility:** To ensure good customer service, you need to be able to have up-to-date visibility into the status of each consumer order. With a drop ship fulfillment model, this can only be done via electronic document exchange. Each vendor will need to be able to not only accept electronic orders, but also provide updated statuses in a timely manner. The most common set of status updates is:
    - o   Order Received
    - o   Order Accepted / Rejected (at a line item level)
    - o   Expected Ship Date
    - o   Shipment Date and Tracking Number
    - o   Invoice

- **Shipping Costs:** Drop shipping is attractive because it reduces the number of times that a product needs to be moved, thus reducing the associated transportation costs. Most drop shipping programs rely heavily on small package carriers like FedEx and UPS vs. LTL or Freight carriers. There are two ways of managing shipping costs with small package carriers:
    - o Retailer Paid: This is by far the most popular method. Because of a retailer's ability to negotiate volume discounts, it is usually far less expensive per package, if the shipment is booked on the retailer's account. The challenges of having the vendors use the retailers shipping account include; distributing of the account information in a secure way and reconciling shipping charges to specific vendors.
    - o Vendor Paid: Because it is very easy to setup and maintain a small package carrier account, many vendors will already have systems and processes to book shipments. By leveraging their existing account, you may be able to accelerate adoption using this method. The risks involved in this model include potentially higher shipping costs and invoice reconciliation.
- **Shipping Methods**: Drop shipping can also reduce transportation costs if it is optimized in a way that shortens the distance the product has to be shipped.   By having more locations where your inventory resides, you increase the chances that the products may be closer to the consumer. It is far less expensive to do next day delivery if the product and consumer are in the same city vs. flying it from your distribution center across country. In order to achieve these savings, you need to be able to:
    - o Collect product location data which may entail multiple distribution locations per product / per vendor
    - o Optimize your order management system to determine the correct distribution location based on the consumer location
    - o Establish and manage shipping method rules with your vendors