From Profit Center to Competitive Mandate

Shifting Your Shipping Strategy

Although the rush of consumers shopping online shows no signs of slowing, with an increase of 15% during the 2011 holiday season alone, many retailers' shipping strategies haven't kept pace.

A December survey of 8,000 U.S. consumers revealed that 86% thought free shipping was important or very important when shopping online. And retailers responded—93% of retailers said they offered free shipping at some point during the 2011 holiday season, according to the National Retail Federation.

No longer a standalone profit center, shipping pricing and policies have become potent and competitive tools to drive revenue and market basket size. Competitors like Zappos and Amazon have stretched the use of shipping and returns policies well beyond the seasonal promotional spur to become a core component of their brand's value proposition.

Consider the implications. The question is no longer "How much does this policy or promotion cost?" but rather "How does it support the brand and drive sales?" Given that consumer and competitive pressures to offer discounted or free shipping will only increase, how should a retailer think about profitability related to shipping?

Since shipping is now a marketing strategy, we should evaluate it on its ability to support the brand and improve sales. An effective modern shipping strategy may not stand alone as a profitable offering, but should increase revenues and profitability by driving changes in customer behavior. Similar to other marketing initiatives, a successful shipping strategy should increase basket size, conversion rate and purchase frequency, among other metrics.

Consider taking a page from Tony Hsieh, CEO of Zappos. In a recent article in *Harvard Business Review*, he laid out his view that while shipping alone may not always be profitable, it should spur long-term sales and customer loyalty.

"In the United States we offer free shipping both ways to make transactions risk free and as easy as possible for our customers. A lot of them will order five different pairs of shoes and then send back the ones that don't fit or that they simply don't like—free of charge. The additional shipping costs are considerable for us, but we view them as a marketing expense. We also offer a 365-day returns policy for people who have trouble making up their minds. (Originally our returns policy was only 30 days, but we kept increasing it at the urging of our customers, who became more loyal as we lengthened the returns period.) Our returns run high—more than a third of our gross revenue—but we've learned that customers will buy more and be happier in the long run if we can remove most of the risk from shopping at Zappos."

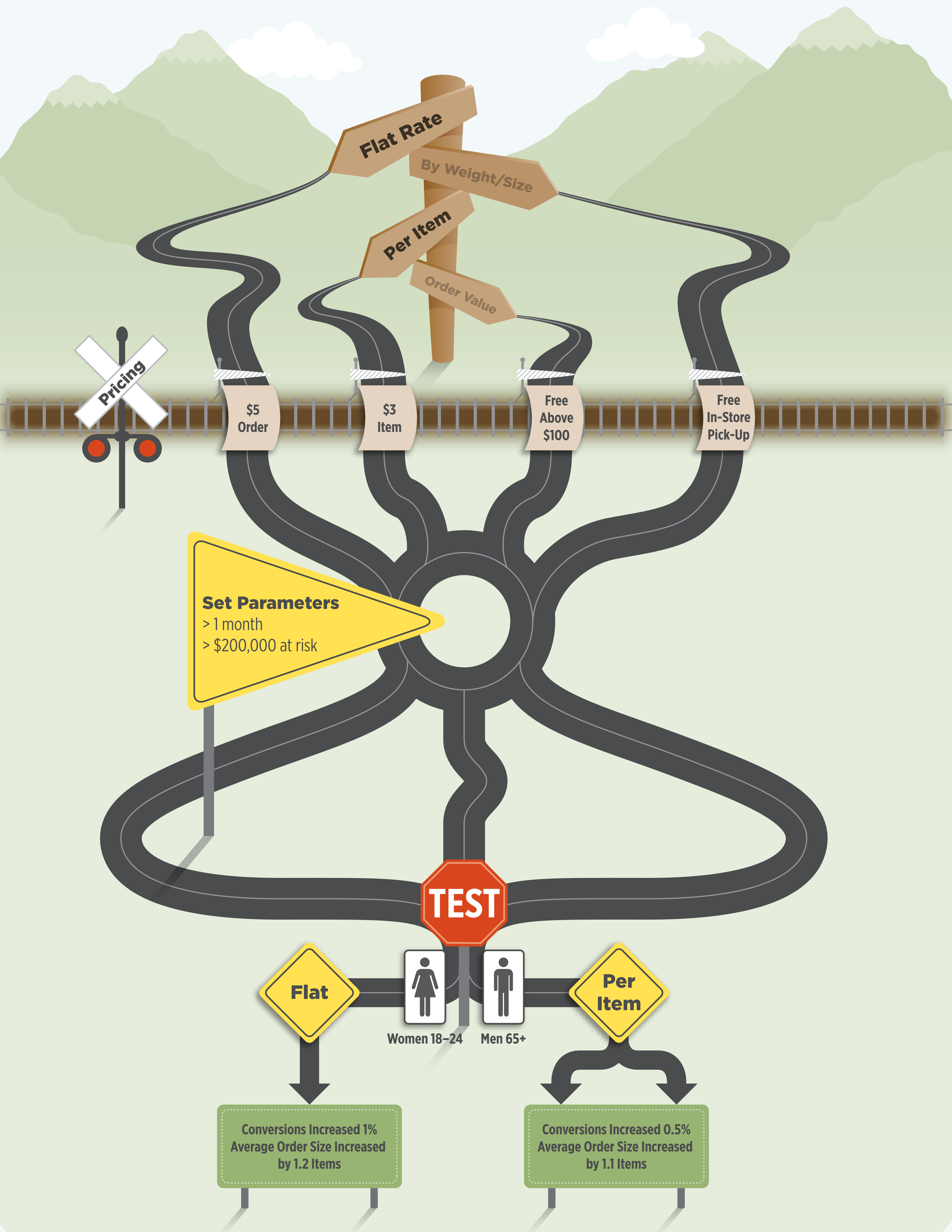
Here, then, are the four key considerations to guide the development of an effective shipping strategy:

1. **Brand and customer attributes.** The brand experience must transfer not only across channels, but through the entire purchasing and receiving process. In a Kurt Salmon study of 50 retailers' online shopping and shipping processes, Saks set itself apart with high-quality custom gift-wrapping, ensuring the luxury experience carried over to receiving the product. But a brand targeting lower-income consumers may instead focus on keeping the consumer's costs down. An order from Walmart.com may arrive without tissue paper or a fancy ribbon, but Walmart offers numerous ways for customers to receive the order quickly at no or low cost and with very little lead time.

2. **Product attributes.** Shipping strategy will be impacted by the size, weight, value and margin of a retailer's products and how much these attributes vary across a retailer's assortment. Consider the case of a specialty home improvement retailer. The retailer wanted to be seen as a one-stop shop for all things home improvement, but offering free or flat-rate shipping meant losing money on some products. To battle these losses, the retailer added a shipping charge to oversized items, set a minimum price threshold for free shipping eligibility and identified a set of low-margin SKUs for which home delivery would no longer be available.

3. **Infrastructure.** Promotions will cause spikes in Web traffic, as well as sudden increases in required labor and supply chain capacity. Key features like in-store pick-up and two-way shipping also require additional infrastructure investments. Of course, these infrastructure elements can be built, but a retailer's current capabilities should be considered when deciding how quickly a given strategy can be implemented.

4. **Strategy considerations.** Is the retailer ahead or behind on revenue or margin targets? Does the retailer have too much or too little inventory available? Is the retailer considering only direct channel sales when impacts on store lift should also be considered? These larger strategic questions will help guide the development of a shipping strategy that will help meet overall business objectives.



Flat Rate
By Weight/Size
Per Item
Order Value
Pricing
$5 Order
$3 Item
Free Above $100
Free In-Store Pick-Up
Set Parameters
> 1 month
> $200,000 at risk
TEST
Flat
Per Item
Women 18–24
Men 65+
Conversions Increased 1%
Average Order Size Increased by 1.2 Items
Conversions Increased 0.5%
Average Order Size Increased by 1.1 Items

It's also essential to test any new shipping strategy as if it were a marketing or promotional campaign by following these steps:

1. Decide which models to test (see illustration on the previous page for an example with several models). There are a virtually infinite number of options, and the more a retailer can test within budget and resource constraints, the better. Deciding which models to test depends on the four considerations above.

2. Layer in pricing for each model. Best practices dictate testing several prices for each model and layering in a free shipping threshold for each.

3. Set parameters for how long the test will last and how much shipping profit will be at risk.

4. Begin testing each model and price combination across multiple customer segments and order or product types. The results of these multivariate tests will help illuminate which shipping strategies to keep and which to toss. Look for increases in new and returning customer visits, conversion rates, basket size and value, units per transaction, and purchase frequency.

These metrics will help determine the ROI of the new strategy and whether it is encouraging purchases without hitting the supply chain with unsustainable costs

In the example in the illustration, flat rate was the clear choice because it had the strongest impact on positive behavior, such as increased conversion rates and order sizes, while impacting shipping income less than the other models. In fact, for one Kurt Salmon client who followed this process, the flat rate shipping model had the potential to increase gross margin dollars by 2% to 5%.

Clearly, the right shipping strategy can not only increase customer loyalty and market share, it can actually pay for itself, and then some. ❖

AUTHORS

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