

Drop Ship Fulfillment

IMPLEMENTATION AND MANAGEMENT BEST PRACTICES FOR SUCCESS SHIPMENTS

- Implementation and management of a drop-ship fulfillment program directly impacts the bottom line and the customer experience.
- Establish program operational requirements and service expectations before engaging drop ship fulfillment suppliers.
- Set realistic high level performance goals to measure and manage program compliance.
- Address drop ship life cycle best practices for purchase orders, packing slips, order fulfillment, shipping, invoicing, inventory and returns.
- Deploy a dedicated team of people with specific authority and responsibility for the operational management of the drop ship program.
- Drop ship fulfillment imposes unique connectivity, security, exceptions management and IT maintenance considerations.

INTRODUCTION

In seeking to gain the substantial benefits of a drop ship fulfillment program, it is often unclear where and how to begin. How the program is implemented and managed will directly impact your customers' experience and your bottom line. This document explains some of the decision points in getting started with a program along with suggestions that are considered best practice.

It is important when making decisions on your program to stay focused on the primary objectives: effective control and management of the supplier network and providing the best service to your customers. Decisions on how your program is implemented should not be based on the least cost or technology alone. You need to consider all factors that impact your customer's experience and your bottom line.

You must make decisions regarding service level, business rules, technology, and how your fulfillment network will be managed. With each of these, approaches can be taken that range from the overly simple to the overly complex. You want your

network to include the widest range of suppliers and products possible. At the same time, require that your fulfillment partners operate within Federal Trade Commission (FTC) fulfillment windows and provide your customers with the experience they expect from your brand.

Your choices must balance the need for program flexibility, control and management, ease of implementation, and speed to market. The decisions made in a drop ship program implementation can ultimately determine the life-long return on investment of the entire effort. The addition of manual processes will hamper the scaling of your program. Poor choices on these early decisions are the reason some drop ship initiatives fail.

Finally, you'll need to decide what third party applications and/or services you'll use, if any, in building your operating infrastructure. Any product or service that is selected should be backed by a company that has many years of industry experience, existing direct relationships with thousands of drop ship suppliers, and a proven track record of enabling profitable

and successful drop ship programs for leading retailers.

The best practices outlined below strike a balance that achieves program flexibility and operational excellence.

Supplier Identification & Selection

When determining your list of potential suppliers, take into consideration the types of products and price points that will be part of the program. From here you can then begin to narrow the list of suppliers. It is important to align yourself with suppliers that have a proven record with fulfilling drop ship orders. You want suppliers that have achieved basic drop ship goals such as shipping orders on a consistent basis, providing high quality products less likely to be returned, and meeting requirements for timely updates regarding the status of orders.

Before you engage with suppliers, it is important to establish your operational requirements for the program up front. Communication requirements to the suppliers on your program is critical. These requirements should be documented in writing and presented to each supplier. The requirements

should include best practices which will meet your program goals. In addition to the requirements, this document should list any third party costs.

When determining the operational requirements, there are certain elements which are considered “must haves” and should be consistent across the program. Must haves should include at a minimum the following requirements:

- **Full message compliance**—all suppliers should be required to exchange the full set of messages that are needed to ensure that your systems are accurate as to the state of orders and inventory levels for items.
- **Shipping timeframes**—should be established so that suppliers are aware of when they need to ship an order after they have received it. Typically drop ship orders are shipped within 48 to 72 hours after receipt.
- **Inventory availability**—at a minimum suppliers, will need to update inventory availability and stock level once per day.

Optional or “nice to have” requirements for your drop ship program include features you may want to consider after your drop ship program is established and running smoothly. These types of features or requirements would be gift wrapping, personalized products and special packaging that require branding above and beyond packing slips. Adding these requirements may reduce the universe of suppliers who can comply.

Contractual Matters

The contract with your drop ship supplier should be simple and straight forward. Having detailed and complicated contracts will only add time since legal departments will need to be involved. The contract should be limited to the financial obligations, terms and conditions, liabilities, whether the supplier will receive a return directly from your customer, and how often they will need to provide updated inventory availability. Penalties and compliance chargebacks should not be part of this contract.

The operational guidelines which you establish for your drop ship suppliers should be referenced in your contract but signed off separately. You will need to enforce the compliance with the suppliers as an operational matter and deal with repeated problems in a firm and straight forward manner.

Supplier On-boarding

The supplier on-boarding process should be consistent and clear with all suppliers. It should begin with an introduction of the program, its purpose, requirements and expectations. This should be a written document which doesn't vary from one supplier to another.

We've seen the best success when the team responsible for the on-boarding process is part of an operational function and not merchandising, although merchandising should certainly have input into the relative priorities of the suppliers to be added from a business standpoint. There should be a single person on this operations team with the authority to schedule, prioritize and communicate timelines in your organization, with the suppliers and with any third party you may use for enablement services.

Areas which should be covered with suppliers during their introduction to your program should include the following.

- Review of requirements and expectations.
- Timing of your contract procurement with suppliers.
- Content gathering creation for web site.
- Setup and testing timelines with ASP/ VAN/ other thirdparties, if applicable.

If you choose to work with a third party you need to have a clear understanding of roles and responsibilities internally as well as with your Application Service Provider (ASP) regarding timing and the overall duration to take a supplier from initial contact to production ready. While working with your ASP, you should establish repeatable and consistent processes to ensure that on boarding

goes smoothly for all parties. These processes and steps will determine the average length of time it should take for on-boarding. You should work towards staging supplier on-boarding into phases with specific goals for how many to complete in a given month.



Service Expectations

Things you should expect from a drop ship supplier:

- Overnight or next day shipping when requested
- 48-hour fulfillment on most items
- Regular inventory availability updates
- Branded pack slip included with each shipment

Things you can expect in some cases from a drop ship supplier:

- Direct to supplier returns
- Personalization
- Gift wrapping

Things you should not expect from a drop ship supplier:

- Multiple order consolidation
- Assembly
- Item substitutions

DROP SHIP LIFE CYCLE

Purchase Orders

While a given customer sale within your Order Management System may be sourced to multiple suppliers, a given supplier must receive an order with only the lines they are expected to fulfill.

It is considered best practice not to send the ASP an order with the same purchase order number for a single supplier multiple times. Purchase order number reuse with the same supplier should be avoided. Some retailers reuse purchase order numbers with a given supplier. This can happen, for instance, when an order is cancelled due to an item being on backorder. When the item comes back into stock, the retailer may resend the original order rather than issue a new one. Most suppliers have systems that automatically reject duplicate purchase orders from a given retailer. Even when "proper" duplicates can be accommodated, allowing for this increases the likelihood that 'improper' duplicates are fulfilled.

A single order should have only one ship-to address. If you provide your customers with the ability to specify multiple ship-to destinations on a single customer order, these should be split into multiple orders for your suppliers. Most drop ship suppliers are not able to process orders with multiple ship-to addresses.

Other key criteria for Purchase Order messages;

- Drop shipping requires more data than your replenishment orders. You should plan, from the beginning, to add information to your existing Purchase Order message.
- In addition to your SKU the Purchase Order should also include the vendor SKU and a description of the item.
- You should be responsible for selecting the carrier and service level that the supplier is expected to use to ship the items. Exceptions can be allowed but you should be in control of how and by whom

the items are shipped. Giving suppliers another decision point only complicates operations.

If you elect to work with an ASP;

- You should send your ASP a single batch transmission that includes Purchase Orders for all suppliers with appropriate identification. There is no need to send separate files for each supplier.
- A Purchase Order should contain all data needed to create the packing slip and for the suppliers to fulfill the items. The process should not rely on data coming from other sources or data that is maintained by the ASP.



Packing Slip

It is important that shipments from your drop ship suppliers contain a packing slip with your branding and design. Suppliers can achieve this either by using packing slips your ASP provides or they can produce their own. In the case of highly automated supplier operations, it may not be reasonable to expect them to use the packing slip created by the ASP. These suppliers have processes which can only work efficiently when they create the packing slip.

You should have a process in place to certify the supplier created packing slips to ensure they meet your layout requirements and corporate logo standards. You should not rely on the ASP to certify the supplier created packing slips.

The packing slip should be easy to produce. Branding and design should be similar to, but not necessarily duplicate the one your warehouse produces. Striving for perfect unison will be more work than is necessary, especially in keeping up with changes long term. It is also best practice that the packing slip not be used as an invoice. The introduction of pricing on the packing slip complicates processing logic related to partial cancellations, gift orders, etc.

As decisions are made about the packing slip, it is important to achieve a balance between marketing standards and operational challenges involved in meeting certain standards.

Fulfillment

You should concentrate your efforts on managing your most common fulfillment scenarios. To do this, you must understand your existing mainstream business. This includes the types of orders, items, turn-around times, customer expectations and business rules.

Plan your program so that it maximizes efficiency with your mainstream business, not the exceptions. Treat exceptions as exceptions.

A supplier should be expected to pick up orders within 12 hours of their availability. In most cases, the supplier should confirm shipment or cancel the order within 48 - 72 hours. Cases where this might not apply would include made-to-order items, pre-orders, or perishable products that must be shipped between Monday and Wednesday so they are kept in a refrigerated warehouse over the weekend.

The fulfillment rule that gives you the most control is to have purchase orders either completely shipped or cancelled by the supplier. Expectation of the supplier needs to be aligned with the ability on your side to process it. It is a common expectation of suppliers that they will fulfill all items that they have in-stock and only cancel the ones that can't be fulfilled within the expected ship window. This strikes

the best balance between fulfillment flexibility and management complexity.

Most order lines have a quantity of one, and a simple policy is quick and easy to comply with.

The fulfillment confirmation should enable the supplier to communicate whether the order has been shipped or cancelled. If shipped, tracking information should be included. If cancelled, an acceptable cancel reason code should be included.

Backorders are best handled by your Order Management System (OMS) rather than by the supplier. This allows you to make the decision as to how to best handle a fulfillment problem, i.e. whether to re-issue to the supplier when stock becomes available, re-source to a new supplier, or to notify the customer that the item cannot be fulfilled.

Shipping

Best practice is to keep the program simple by minimizing the number of allowable carriers and service levels. You should expect a supplier to support shipping via UPS, FedEx, USPS, and DHL, as well as a selected Less-than-Truckload(LTL) carrier.

It is recommended that you provide each supplier with an account which is linked to your main carrier account. This will reduce the need for suppliers to provide shipping charges during the fulfillment process and allows you to audit what is being charged.

Perishable items requiring Second Day Air service can only be expected to ship between Monday and Wednesday. Products shipped with Next Day Air will have a shipping window of Monday through Thursday.

Less Than Truckload (LTL) Shipments

It is important to understand the limits of parcel shipments and when you will need to become involved in LTL shipments. Any shipment over 70 pounds is considered above the standard parcel weight limit. Some parcel carriers may handle heavier

shipments but delivery of these items becomes more complicated because of size.

Another consideration when using an LTL carrier is whether your business side can support the higher shipping costs and the extra attention that is required to ensure customer satisfaction.

Invoicing

In the drop ship environment, where items are being purchased at a pre-negotiated cost and shipped directly to customers, the most efficient approach is to use the Fulfillment Confirmation message both to update the status of the customer in the Order Management System and as an invoice feed into the Accounts Payable system. This eliminates the need for the supplier to submit a separate Invoice message to request payment after submitting the Fulfillment Confirmation message. The supplier can include the monetary amounts and Invoice number necessary for the A/P feed as part of the Fulfillment Confirmation message, and the package tracking information included in the Fulfillment Confirmation message allows for auditing of shipments and fulfillment that is generally considered sufficient. This practice is commonly referred to as 'scan based billing'.

It is best practice to include all handling charges in the unit costs agreed upon between you and the supplier. Requiring the supplier to add this fee during the fulfillment process increases the complexity.

You should seriously think about the payment process. While you will be getting invoiced on a shipment basis, your payment to the supplier should be consolidated and delivered with a detailed remittance advice.

Inventory

Inventory for drop ship selling has to be addressed differently than selling out of your own warehouse or stores. You will not be doing traditional inventory control for these items. In drop ship selling the only

requirement is to avoid creating orders for items the supplier can not fulfill. There is no requirement to manage an inventory asset.

You should expect the suppliers to communicate with you on a regular basis on the status of their inventory. Your contract with the supplier should stipulate the frequency with which they must refresh their product availability levels. Daily refreshes are sufficient for many products, but your contract should be specific about update frequency for high velocity or short supply items. Changes in SKU status such as an item being discontinued should be sent along with quantity updates.



If you use an ASP, they should consolidate SKU's across your entire drop ship supplier network and deliver you an inventory 'advice' that provides a unified inventory picture of product availability on a schedule that meets your requirements. It is recommended that a full inventory advice be accepted on a weekly basis to insure that your system and the ASP system are in-sync in terms of the SKU roster. On a daily basis, 'incremental' advice(s) will convey refreshed counts for active SKU's as they are reported.

This inventory advice is the means by which you manage your web or call center selling to avoid accepting orders for product that is no longer available. Consideration should be given to safety 'thresholds' that balance the desire to maximize orders taken with the customer side impact of cancellations. Keep in mind that this

inventory is generally not allocated, so suppliers will be accepting orders for the same item from other retailers.

Returns

There are pros and cons to any one method of handling returns. If you have infrastructure and processes in place to accept returns to your facilities and aggregate them in a shipment to suppliers this can be used.

If you are supporting returns directly to a supplier, it is recommended that the supplier provide Returns Notification to your ASP for all returns they receive. The ASP should then produce a return notification to you for use in reconciling the return with the customer. These returns should be applied to an open RMA, and not require individual RMA assignment.

Packing slips should provide instructions to the customer as to how to handle a return situation. It is best for the return policy to be consistent across product all products and the instructions be simple and clear for the customer to follow. Consider exceptions such as perishable products and how these need to be handled.



MANAGING YOUR DROP SHIP PROGRAM

Drop Ship Operations — Staffing & Business Management

In our experience, one of the keys to success is to deploy a dedicated team of people with specific authority

and responsibility for the operations management aspects of the program. This team needs to coordinate and execute a variety of implementation, supplier on-boarding and daily monitoring tasks. They are in the best position to manage a queue of work as multiple merchandisers identify candidate suppliers and products, and to establish the achievable timeframes for the on-boarding process. This team should also be responsible for program compliance monitoring and enforcement. This leaves the merchandising team in the “good cop” role of business development only.

In addition, we recommend that a single person be given responsibility for prioritization decisions and task coordination for the on-boarding process. These scheduling and timing decisions need to be communicated to all parties (your organization, the suppliers, and third parties, if any) in a clear and timely fashion.

The daily monitoring and control of specific order fulfillment events requires consistent and disciplined attention. The drop ship operations team needs to include an expediting function, so individual problems identified by the visibility and compliance tools can be dealt with before customers are impacted.

Program Compliance & Supplier Performance Management

The internal tools or third party services you choose should provide you with real-time, end-to-end visibility into each discreet purchase order and shipment event across the supply chain. Anyone in a retailer’s enterprise should be able to quickly access the status of orders, shipments, and other critical information through an executive dashboard with summary views, detailed views, pre-built quick searches and a powerful but simple ad-hoc query builder tools.

You should expect to have features that provide you with graphical historical performance reports, supplier scorecards and more. These should allow you to see the big picture

of how your supply chain is performing over time.

Focus on establishing realistic high level performance goals. The critical metrics in drop ship include:

- **Maintaining high availability of critical SKUs**—which depends on effective forecasting between the merchant and supplier.
- **Fill rate**—which is impacted by the accuracy and currency of the inventory availability advice provided by the supplier.
- **Shipping time**—set appropriate to the type of product. One of the challenges of the drop ship model is that it’s different from the familiar “owned inventory” model.

Generally, drop ship suppliers do NOT allocate inventory to a specific retailer. They will fill orders from various sources as they arrive. This means inventory availability information will not be as current as under the in-house model, and the merchant needs to take this into account in setting safety levels for order taking and setting performance metrics for suppliers.

We recommend staying away from the imposition of financial penalties for compliance failures until the drop ship program matures. This will encourage entry into the program and avoid the behavior of having suppliers take an overly conservative stance on cost, response time capabilities and other service level components. It will give all parties time to settle into acceptable levels of performance. Once that is accomplished, the retailer can tighten performance standards and consequences.

We think best practice implementations include tools that support four important characteristics – visibility, managing the process by exception, communications with suppliers and ad hoc reporting and searching. Specific capabilities include:

Visibility

- Shared view of data between you and your suppliers

- Complete order life cycle status information
- Summary of active transactions with drill down to details
- Performance metrics based on historical data

Manage by exception

- Establish thresholds appropriate to the supplier/supplier group/product
- Automatic alerting for orders about to violate — in time to intervene and prevent a bad customer experience

Communications with suppliers

- Facilitate communication to resolve exceptions

Ad Hoc reporting and searching

- Specific orders
- Summaries and trends

TECHNICAL IMPLEMENTATION

Connecting to a wide variety of suppliers under conditions where a large number of transactions must be exchanged reliably under tight time constraints places several burdens on

the retailer. As opposed to the familiar bulk fulfillment model, this mode of operation must process a large volume of small orders, each with a customer's buying experience hanging in the balance. These include:

Accommodating a wide variety of supplier-side technical environments and data communications capabilities.

- The choice here is to offer only a single (or small number) of "standard" implementation alternatives or to take the workload and maintenance complexity of allowing many variations. In the first case, you will likely limit the number of suppliers that are willing or able to connect. In the second, you incur dramatically higher operations costs and implementation time frames

Data security

- Individual customer data and sometimes cost information is transmitted in this model, so best practice includes encrypting data communications. Once again, suppliers will have varying approaches and capabilities for meeting this requirement.

Troubleshooting operations

- Regardless of program rules, suppliers will respond to orders with transactions that violate data structures or choreography rules. Your operations staff will need to be prepared to detect these exceptions and interact with each supplier to correct them.

Managing technical changes in any of the participants technical environments as the program progresses.

- Over time, various suppliers and probably even your own operations will change. This will create an ongoing operations and technical maintenance responsibility to maintain the connections and choreography as IT systems change.