

FREE SHIPPING IS NOT ACTUALLY FREE



- 1) After being offered free shipping for various purchases over a number of years, consumers have largely come to expect the service when they buy products online.
- 2) Retailers are usually the ones absorbing the high logistics costs associated with shipping, even for low-cost items and small-basket purchases, as consumers now expect free shipping with every order, no matter the size.
- 3) In a 2016 Walker Sands survey, nine out of 10 consumers polled said that they would shop online more if shipping were free, versus eight out of 10 in the previous year's poll.
- 4) In 2006, Amazon's shipping costs totaled \$317 million, or 3% of the company's total revenue. Between January and October of 2016, Amazon's shipping costs totaled \$4.6 billion, or 5% of total revenue.
- 5) Shipping costs can be absorbed by retailers for a short period of time, depending on their liquidity, but the free-shipping model is unsustainable long term for profitable retailers that have a responsibility to shareholders.

For e-commerce companies, shipping products to customers' homes is part of the formula. According to *Fast Company*, the trend of offering free shipping first started with e-commerce giants Amazon and Target. Now, so many companies have offered free shipping, for so long, that consumers simply expect it with every online order.

Back in 2009, *The Wall Street Journal* reported on Target's launch of free holiday shipping. That year, the retailer started offering free shipping two weeks earlier in the holiday season than it had in 2008, and made twice as many items eligible for free shipping. Walmart and Amazon battled it out during the holiday season that year, both

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offering popular books at a deep discount, although Walmart offered free shipping on the items.

In 2009, offers for free shipping looked much different than they do today:

Getting the Goods Delivered ... Gratis
 A bevy of online stores are extending free shipping deals. Here are a few.

Retailer	Ongoing free shipping offer	Special holiday shipping deals
 TARGET	None	Offering free shipping on a variety of items, with a \$50 minimum, starting on Nov. 2.
 Walmart	None to home but company will ship free to a nearby store.	Free shipping on 10 popular books, which can be pre-ordered now.
 Zappos <small>POWERED BY SERVICE™</small>	Free standard shipping and free returns.	None. The company offers year-round free shipping, but says it likes to "delight" shoppers by occasionally upgrading them to overnight shipping.
NORDSTROM	Free shipping for orders over \$200; free shipping with no minimum for "Level 2" and up loyalty program members who spend \$2,000+ per year.	Free shipping on purchases over \$100 starting Nov. 2; currently offering free shipping on shoes with no minimum purchase requirement.
 bloomingdales	Cardholders get free shipping with minimum purchase of \$150; everyone else must spend \$300 to get free shipping.	A spokeswoman for the company says that "plans are still being finalized."
 Saks Fifth Avenue	In addition to sporadic free shipping deals throughout the year, World Elite Mastercard holders and SAKSFIRST loyalty program members (who spend over \$1,000) get free shipping.	Christmas offer of free shipping with no minimum purchase requirement begins in early November and continues through the holiday season.

Source: *The Wall Street Journal*

As e-commerce competition increased, retailers began racing to offer more free-shipping options in order to gain brand loyalty. Many extended the service beyond the holiday season, and it became a mainstay for online retailing. While free shipping is highly desirable from a consumer standpoint, retailers are usually the ones absorbing the high logistics costs, while struggling to maintain competitively low product costs.

According to a 2016 study by communications firm Walker Sands, free shipping is the most important factor among consumers who shop online, with nine out of 10 people surveyed saying that they would shop online more if shipping were free, up from eight out of 10 in the previous year's survey.

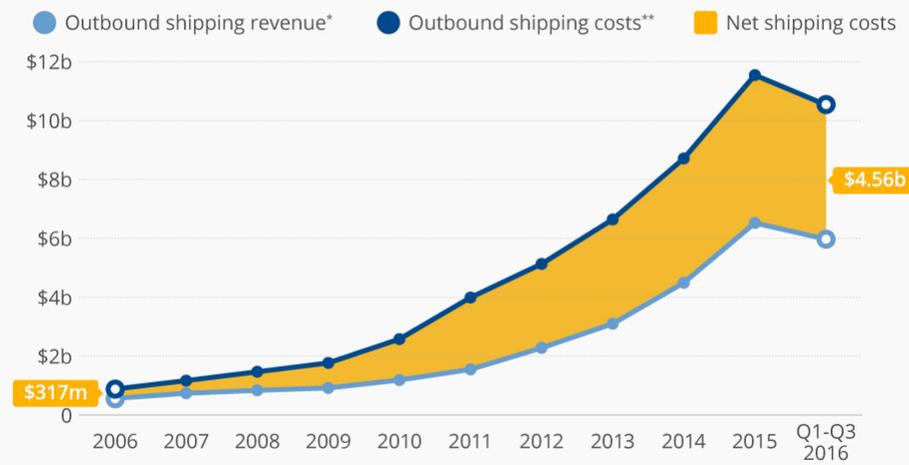
The same study found, however, that only 19% of the top 250 retailers can fulfill omnichannel demand profitably. In 2015, retailers spent 29% of their capital expenditures on fulfillment issues, including transportation, logistics, delivery options, order management, inventory visibility and returns management, according to Walker Sands. Retailers clearly face a challenge in covering supply-chain costs while meeting customers' expectations of free shipping.

Amazon Prime, launched in 2005, aims to get customers to pay for the free shipping that the company initially balked at, and to eliminate shipping surcharges. Prime members paid \$79 a year for free two-day shipping on all Prime-eligible purchases. Now, 11 years later, Prime members get those same benefits for \$99 a year. Amazon continues to raise the bar regarding shipping expectations; it now offers same-day and even one-hour delivery with its Amazon Prime Now service. However, the company's shipping costs as

a percentage of revenues have continued to grow as the business has expanded, posing a costly challenge for Amazon. According to the company, shipping costs totaled \$317 million in 2006, or 3% of total revenue. Between January and October of 2016, Amazon's shipping costs amounted to \$4.6 billion, or 5% of total revenue—and that percentage figure is expected to be even higher after the holiday quarter, which is traditionally the busiest and costliest in terms of supply chain.

The Ever-Growing Cost of Amazon's Shipping Operations

Costs and revenue associated with Amazon's outbound shipping activity



* includes a portion of amounts earned from Prime memberships
 ** includes sortation and delivery center costs
 Source: Amazon.com



Source: Statista/Amazon.com

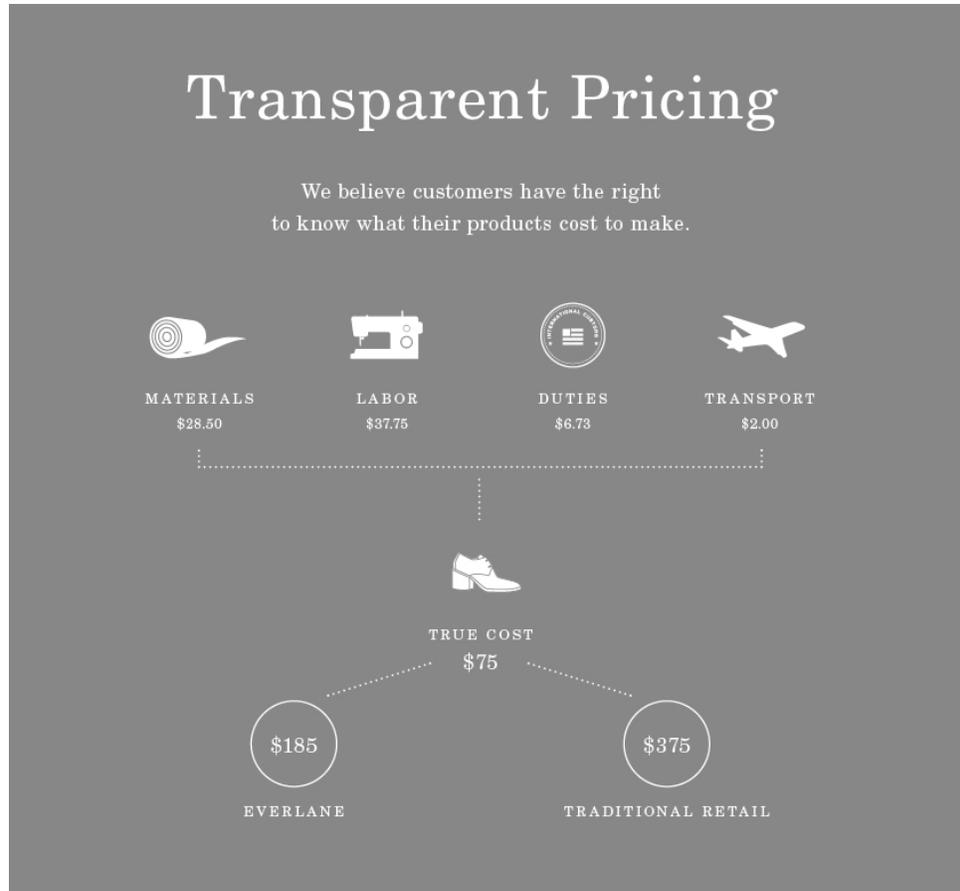
Jet.com initially offered a membership program that was similar to Amazon Prime. The company charged \$50 a year for free two-day shipping, but the program did not last long, and the company settled with free shipping on all orders over \$35. Jet attempted to lower its logistics costs by matching customers with products and inventory that were located closest to them by partnering with local retailers, including Walmart, which recently acquired the company. The cost of shipping was likely weighing heavily on the e-commerce pure play. The acquisition by Walmart provided Jet with the distribution centers and logistics tools and infrastructure it needed, along with the capital to offset the high costs of shipping, for now.

Amazon and Jet, due to their relative size, can better afford to absorb the price of shipping than smaller e-commerce retailers can. Smaller retailers must therefore decide whether it is better to be up front with customers about the cost of shipping or to increase ticket prices on items in order to cover the cost of “free” shipping.

Meanwhile, consumers are demanding more transparency than ever before at all levels of the supply chain, and some companies are making efforts to meet their demands. Patagonia, for example, offers consumers a complete overview of all its products through an interactive tool on its website called *The Footprint Chronicles*: site visitors can use the online tool to learn about the company's textile mills and factories and even the farms where it sources its merino wool.

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Consumers also desire transparency about pricing. In response, e-commerce pure play Everlane offers customers complete price transparency. The company claims to “eliminate brick-and-mortar expenses” and outlines for shoppers all of the costs associated with the production of its items. A pair of Italian leather-heeled oxfords costs \$185 at Everlane, versus \$375, on average, at traditional retailers, according to the company. Everlane offers free shipping and returns within the US, although it currently does not factor the price into its “Transparent Pricing” schema. The company is reportedly seeking a valuation of more than \$250 million, according to *Quartz*.



Source: Everlane

There are ways for retailers to combat the high cost of shipping associated with e-commerce, including by offering click-and-collect and the option for shoppers to pick up their purchases at a centralized location, as Amazon does with its Amazon Lockers. Amazon has also made moves to begin to gain control of its own supply chain, leasing 40 of its own air freighters (an additional nine planes are in the works) and opening distribution centers near its customers. According to Piper Jaffray analysts, about 44% of the US population now lives within 20 miles of an Amazon facility.

Amazon has also worked to test drone delivery in order to cut shipping costs, although this likely will not become a reality until after the Federal Aviation Administration issues regulations for low-flying aircraft, which it is not expected to do until sometime in 2019. Consumers have also expressed some distrust in drone delivery. According to a Walker Sands survey, only 40% of consumers describe themselves as “very likely” to select

drone delivery as a shipping option, even if the package could be delivered within an hour.

In sum, shipping costs can be absorbed by retailers for a short period of time, depending on their liquidity, but the current model of free shipping is unsustainable for profitable retailers that have a responsibility to satisfy their shareholders.



Source: Shutterstock



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Deborah Weinswig, CPA

Managing Director
Fung Global Retail & Technology
New York: 917.655.6790
Hong Kong: 852.6119.1779
China: 86.186.1420.3016
deborahweinswig@fung1937.com

Rachael Dimit

Research Associate

HONG KONG:

8th Floor, LiFung Tower
888 Cheung Sha Wan Road, Kowloon
Hong Kong
Tel: 852 2300 4406

LONDON:

242-246 Marylebone Road
London, NW1 6JQ
United Kingdom
Tel: 44 (0)20 7616 8988

NEW YORK:

1359 Broadway, 9th Floor
New York, NY 10018
Tel: 646 839 7017

FungGlobalRetailTech.com