White Paper | by Hannah Kain, CEO, ALOM

Simple Fulfillment Errors will Affect the Bottom Line

Summary

Shipping errors can be expensive. They impact customer satisfaction, customer retention, and profit. Ultimately, “simple” shipping errors can impact the entire organization and cause customer relationship and even cash flow problems. This white paper illustrates scenarios to show how “simple” shipping errors can become costly along with common consequences of shipping errors.

Most customers buy from a specific company because they like the product or the price. Fulfillment and delivery are considered immaterial and transparent. However, if persistent problems arise and continue, the relationship is impacted, and fulfillment can go from immaterial, to irritant, to issue and, finally, to intolerable. The delivery then becomes a deal-killer.

Unfortunately, many companies wait until this situation occurs before they review their fulfillment operations. That's why it's important to assess tactical day-to-day savings of utilizing a high-quality fulfillment company, long before the customer threatens to walk away. In fact, for high-quality products or luxury products, having a quality-oriented fulfillment partner is a must.

There are numerous consequences a company faces. Here are the more common worst-case scenarios when errors occur in shipping and fulfillment:

Lost Customer Loyalty and Trust

When customer loyalty is impacted, there are additional costs. A simple calculation (see "The Cost of Shipping Errors") shows that three fictitious companies can pay substantially more for order fulfillment in order to avoid the risk of losing future orders. If they lost just one order for every misshipped order, they can pay from $1.30 more per order (Great Gadget) up to $152.55 more per order (Big Systems).

Chargebacks and Returns

Most companies feel they are paying too much for collecting their accounts receivable. However, collection costs can become a nightmare if there are fulfillment problems or record keeping problems. Credit card companies reverse charges as soon as they get a complaint, and it is up to the sender to prove that the product was delivered.

Retailers routinely ask for delivery confirmation before paying bills. Companies that rely on accounts receivable for their day-to-day cash flow must consider the risk of delayed payments when choosing the fulfillment partner.

Chargebacks have become common among retailers. Accounting company Grant Thornton categorizes chargebacks into three categories (http://www.grantthornton.ca/ corporate/Conveyor_Fall-03.pdf):

- Negotiated "Intentional" chargebacks, including rebates, advertising allowances, markdown allowances, etc.
- Preventable chargebacks, which are mostly related to logistics and information system failures, such as improper labeling, missing delivery appointments, invoices that don't match deliveries, etc.
- Unauthorized chargebacks, which may be masked as bogus logistics failures, or vague "returns" numbers that don't match what was actually sent back, paying the wrong price for the goods, etc.

Even the smallest IT glitch in advance ship notification to a retailer can cause a delay and a considerable penalty. Chargebacks may go as high as 10% of revenue — a number that can cut significantly into profit. A small supplier that fails to send an EDI acknowledgement within 24 hours of receiving an EDI purchase order — or fails to send an ASN within a certain timeframe, or falls below a certain fulfillment rate or
provides substitutions on an order — might incur a charge ranging from a flat $200 to a percentage of the purchase order sometimes amounting to thousands of dollars.

Being able to control and respond to chargebacks is critical. If a company can save the "basic" penalty of $200 on every fifth order, they can pay additional $40 per order to their fulfillment company.

Sales Force Problems

If orders aren't met, shipped, or delivered a company's sales force might have to step in. Once the sales force gets involved in shipping and fulfillment problems, companies incur a huge cost.

Sales calls cost companies money. A local sales call typically costs around $300 while a non-local call can run several thousands of dollars.

When a sales person is taking care of a complaint, the sales person is missing the opportunity to sell to a new customer — or have a more constructive dialog with the existing customer.

Demoralized sales force is another common problem. Sales people are great at selling, and performing damage repair can be demoralizing to anybody. It is hard to be upbeat on a sales call if you had to fix problems earlier in the day. Then you may just feel that you are creating the next problem that needs to be fixed.

Persistent fulfillment problems can eventually force top sales performers to leave. This, again, can have disastrous impact on the company and can become a strategic problem. Companies using low-cost fulfillment providers need to watch for this problem and calculate the real cost of any fulfillment error.

Avoid High Error Rates

A 1% error rate may seem high. However, the standard industry picking error rate is exactly that – 1%. For example, many online retailers are running up to 30% returns. Of course, only few of the returns are due to fulfillment problems. Most of the returns are probably due to problems with size, color or style. However, with the right vendor-partner, an online retailer can provide real-time analysis of returns causes, make changes on their e-commerce site and avoid the costly returns. Here are three scenarios that illustrate how three fictitious businesses can benefit from choosing an experienced vendor. (For specific information and calculations, see page 7)

Scenario No. 1: Errors Can Eat Profits

Great Gadgets is selling gadgets for $60 direct to the consumer, marketing online. Let's assume a profit margin of 17% corresponding to $10.20 per gadget sold. Let's further assume that the company is shipping 10,000 units per month with one unit per order.

Errors in fulfillment are costly. In fact, if Great Gadgets is selecting a vendor that has even 1% error rate in fulfillment, their profit decreases by 7%. (See assumption on page 7). And if we assume a loss in customer loyalty, the profit can decrease by 13%. If the pick, pack, processing error rate goes up, so does the lost profitability. With a 7-8% error rate, the company will get into a loss situation.

If Great Gadgets chose a different fulfillment company, they can pay $0.70 more for each order being processed at a fulfillment company with 1% less error rate.

Scenario No. 2: Misshipments Equal Lost Time and Unhappy Customers

Let’s review the same error rate, but with shipping the product for a major company, Big System Software, where the sales or technical rep is onsite to supervise the installation.

Let’s again assume a 1% error rate in shipping. Because the installer lost a day, travel time, and travel expenses, assumes that $5,000 is lost because of a misshipment. Including replacement shipping, Big Systems Software could spend $52.50 more per order and break even. In addition, there may be a significant loss of customer loyalty since the installation may be important for the IT department.

The same cost calculation should have been made with a misshipment for a retailer where a sales visit may not be necessary but the retailer initiates a chargeback and the accounts receivables staff must spend time on documentation.

Scenario No. 3: Returns Can Affect The Bottom Line

Heavy Stuff ships heavy packages. The freight cost outbound and back are significant. Let’s review the same 1% error rate in shipping. With a cost of $540 to process a return, expedite new product out to the customer, and testing and potentially scrapping returned product, it takes five new perfect orders to make up the lost profit on the misshipped order. Heavy Stuff can pay $5.40 more per order if they can avoid the 1% error rate.

Summary

As this white paper has illustrated, shipping errors are expensive. Simple shipping errors can impact an entire organization, cause customer relationship, and even cash flow problems. Avoid this by choosing a vendor who has the right systems in place to help achieve a company’s fulfillment and shipping goals and needs.

About the Author

Hannah Kain is CEO and founder of ALOM. Kain has extensive experience in the packaging industry. She has three university degrees, has won numerous awards, including ABWA, NAWBO and Women’s Fund, and has been featured in books and articles, including “CEO Chronicles” and “Women Who Paved the Way.”

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The Costs of Shipping Errors

	Great Gadget	Heavy Stuff	Big System Software
Total orders	10,000	1,000	200
Revenue per order	$60.00	$600.00	$100,000.00
Profit %	17%	17%	65%
Profit $$	$10.20	$102.00	$65,000.00
Total profit	$102,000	$102,000	$13,000,000
Error percentage	1%	1%	1%
Cost of correcting			
Return freight	$10.00	$100.00	$0.00
Issue call tag, returns handling	$10.00	$10.00	$0.00
Call center call	$5.00	$50.00	$5,000.00
Test and potential scrap returned product (assume 25% scrapped, $5 testing cost)	$20.00	$155.00	$0.00
Replacement product			$50.00
Outbound freight, correct product, expedited	$20.00	$200.00	$200.00
Outbound packaging materials, accounting and sales tax reconciliation, misc. internal processing	$5.00	$25.00	$5.00
Total cost per error	**$70.00**	**$540.00**	**$5,255.00**
Total errors	100	10	2
Total cost per month	$7,000	$5,400	$10,510
% of profit lost	7%	5%	0%
Extra per order cost for break-even	$0.70	$5.40	$52.55
Lost loyalty (estimated as average one lost future order for each order with problems)	$60.00	$600.00	$100,000
Total cost per error	**$130.00**	**$1,140.00**	**$105,255.00**
Total errors	100	10	2
Total cost per month	$13,000	$11,400	$210,510
% of profit lost	13%	11%	1.62%
Extra per order cost for break-even	$1.30	$11.40	$1052.55

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