

Guarantee It

BY SATISH JINDEL

Any doubts that logistics and fulfillment are the key to successful online retailing should have been dispelled by this holiday season. The Grinch didn't exactly steal Christmas, but poor logistics by online retailers left many consumers in a decidedly Grinch-like and grouchy mood.

Toys R Us is the target of a class action lawsuit filed in Washington state that alleges the company failed to deliver toys purchased at Toysrus.com by Christmas. A report in the *E-Commerce Times* warned that e-tailers that failed to deliver could face sanctions under the Federal Trade Commission's Mail Order Rule, which governs the performance of mail-order companies.



While online retailers must focus on logistics to improve distribution, one company could do much to ensure the growth of online retailing. United Parcel Service, which owns the lion's share of the business-to-residence parcel delivery market, should guarantee all residential deliveries. Such a guarantee would be a big shot in the arm for e-commerce.

Since UPS is the market leader for business-to-residence ground parcel service, a look at all UPS service offerings explains why residential deliveries for ground service also should be guaranteed. (See Table 1.)

For a long time, the industry limited guaranteed delivery to premium-priced express services only. In 1997, when industry observers exposed the pricing premium for guaranteed air express over comparable ground service, UPS responded with a guarantee for ground deliveries in May 1998. However, it was not offered for residential addresses. The decision to limit guarantees to commercial addresses had to be based on the realization that there was no competitor in the business-to-residence market to preempt UPS, unlike RPS in business-to-business market.

With the surcharges for residential deliveries and increase in business-to-residence volume that reduces delivery cost, UPS should guarantee residential deliveries. Table 2 illustrates the premium for residential deliveries over commercial addresses for a five-pound parcel. The rates are for customers with automatic pickup and for delivery to rural ZIP codes for which the surcharge increases from \$1 to \$1.50 effective Feb. 7.

In addition to revenue surcharges for residential deliveries, UPS has some cost savings in some areas with business-to-residence parcels. For example, the pickup cost for business-to-residence parcels at 7 percent is considerably lower than business-to-business parcels at 12 percent of total operating cost. Other reasons for UPS to guarantee residential deliveries are:

- Residential deliveries for express services already are guaranteed and there is no difference in the delivery process for express and ground services.
- There is no difference in the entire transportation process from pickup to final delivery between commercial and residential addresses.
- UPS guarantees delivery to a small corner store located in a remote rural ZIP code. While it incurs the same delivery cost to a residential address, it has a revenue surcharge of \$1.50 for a residential address without guarantee. With new private competitors entering the business-to-residence market, this discriminatory pricing and service approach is not sustainable.
- UPS drivers release guaranteed express services to residences. Hence, it can do the same for ground service and still guarantee delivery.

The annual revenue for the domestic nonexpress (ground) parcel market is about \$21 billion. The business-to-residence ground market in terms of parcel volume and revenue is about

TABLE 1

UPS Guarantees by Delivery Address

UPS PARCEL SERVICES	COMMERCIAL DELIVERIES	RESIDENTIAL DELIVERIES
Next Day Air	Guaranteed	Guaranteed
Next Day Air Saver	Guaranteed	Guaranteed
2nd Day AM Air	Guaranteed	Guaranteed
2nd Day Air	Guaranteed	Guaranteed
3 Day Select	Guaranteed	Guaranteed
Ground	Guaranteed	Not Guaranteed

TABLE 2

UPS Ground Charges

Commercial vs. Residential Delivery

PRICING ZONE	TRANSIT TIMES	GROUND (BASE)	GROUND (RURAL SURCHARGE)	GROUND (TOTAL)	GROUND COMMERCIAL (TOTAL)	% PREMIUM OVER COMMERCIAL
2	1 day	\$4.32	\$1.50	\$5.82	\$3.32	75%
3	2 days	\$4.60	\$1.50	\$6.10	\$3.60	69%
4	2 days	\$5.07	\$1.50	\$6.57	\$4.07	61%
5	3 days	\$5.30	\$1.50	\$6.80	\$4.30	58%

one-fourth of this total market. Yet there are more competitors in business-to-residence than in the business-to-business segment. While there are over 10 competitors seeking business-to-residence parcels, only two carriers presently have a residential delivery infrastructure. (See Table 3.)

With the business-to-residence parcel delivery market dominated by UPS and the Postal Service, the implications from guaranteed residential delivery are as follows:

- Raise barriers to entry into the business-to-residence market.
- With significant presence in the business-to-residence market, USPS will have to accelerate guarantees for Priority Mail and Parcel Post service.
- The lack of guarantee will hinder Priority Mail growth.
- Many parcel consolidators that use USPS for final delivery will be left to compete for low-end products that are not service sensitive.
- FDX will have to respond by guaranteeing its business-to-residence initiative being rolled out by RPS in March.

The retailers and their customers are looking for improvements in the online retail supply-chain process. Yet even with improvements in their logistics operations, they will be unable to provide a definite delivery date to their customers. While online consumers tend to have higher income and higher service expectations, most items bought over the Internet cannot support the express service charge for guaranteed delivery and are thus shipped via deferred services like UPS Ground.

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According to a study by Zona Research, only 2 percent of online buyers are willing to pay for overnight delivery, and more than half are willing to wait four to seven days. Hence a guaranteed delivery service for residential addresses can enhance the customer experience and promote online sales. The benefits of guaranteed ground service to this industry are:

- Allows online retailers to provide expected delivery date to their customers.
- Enhances the consumer's ability to accept parcel in person.
- Helps online retailer achieve higher level of customer satisfaction.

Over time, the online retailers will feel the pressure of shipping and handling costs, shift their focus from increasing cus-

tomers to managing costs, and gain more clout with parcel carriers. This will allow them to pressure delivery companies to guarantee residential deliveries.

With a proactive response to the needs of the online retailers and consumers, UPS can enhance its market position as follows:

TABLE 3

Competing Carriers

(in the B2R Ground Market)

CARRIER	DELIVERY BY	ABILITY TO GUARANTEE DELIVERY
UPS	UPS	Yes
Priority Mail - USPS	USPS	No*
Parcel Post - USPS	USPS	No
Airborne@home	USPS	No
CTC Distribution	USPS	No
Parcel Direct	USPS	No
Paxis LLC	USPS	No
Harte Hanks	USPS	No
Postal Freight Inc.	USPS	No
RPS Inc. (FDX company)	RPS (starting March 2000)	Yes

* U.S. Postal Service has a minimum 12-month process to implement such changes

- As it faces new competitors in the business-to-residence market (RPS, Shipper.com, Webvan, HomeGrocer, Kozmo.com, etc.) UPS can differentiate its service with an initiative difficult for the competition to implement.
- The introduction of DSCF and DDU discounts by the USPS in January 1999 created an opportunity for consolidators to compete with lower shipping charges while offering better transit times and higher on-time performance. However, their dependence on the Postal Service for the final delivery limits them from offering a delivery guarantee.
- Guaranteeing residential addresses for ground service will simplify internal processes and promote greater accountability since all other UPS services already are guaranteed.
- By introducing this guarantee now, UPS will keep e-tailers from defecting when competitors like RPS guarantee residential delivery.
- It is an opportunity for UPS to be the first to offer a new service as it did with Next-Day Early AM, 2nd Day AM Air and 3-Day Select.
- It can minimize loss of business to same-day delivery carriers.

The delivery cost to a residential address in a rural ZIP code is not different from that to a commercial address. Yet the residential parcel is priced at 78 percent premium without a delivery guarantee. This pricing premium for inferior service cannot be sustained in a competitive market. RPS is expanding its residential delivery service to 50 percent of the U.S. population in March. With more private carriers having the ability to compete on service issues with UPS, the market will demand a guarantee for residential deliveries.

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