Dropshipping as Logistics Business Model of e-Commerce

Introduction

Optimization of all logistics processes is acting directly proportional to the growing importance of e-commerce. Today, we send commercial goods by means of specialized transport companies, which noticed huge potential in e-commerce. They decreased the costs and presented their products to retail customers. We receive payments even if COD (cash on delivery) up to 48 hours, and online payment systems optimize the process of transmission and receipt of receivables [4].

Currently, with the development of logistics and the emergence of new players who want to operate online retailers, there are further opportunities to optimize the logistics chain, which are seen by more and more innovative companies. With models such as dropshipping (especially close to the IT industry, but also noticeable in the fields of clothing and, in fact, available in almost every industry) the threshold of entry into e-commerce has been reduced again. Today, a small entrepreneur with a good idea for a business does not have to block their store without knowing in practice the market, in which they intend to try their hand. Obviously, the lowered threshold of entry into e-commerce, translates into the formation of many misguided, ill-considered and in consequence unprofitable businesses but it also gives great opportunities to young entrepreneurs who do not have the possibility of appearing on the traditional market.

Many entrepreneurs associate logistics mainly with transport, while few know that the essential components of logistics for e-commerce are also all processes related to storage and supply, circulation of documents for payment, as well as resource planning. The role of logistics and its great importance in e-commerce can be argued in many ways, but each more or less experienced vendor is able to agree with the statement that e-commerce is largely logistics [4].

The aim of the article is to analyze the dropshipping model with the characteristics of its actions and to determine its advantages and disadvantages. The theoretical part is based on Polish and foreign literature and enriched with secondary research results and the author's own on the functioning of Polish electronic stores in the presented system. The author's own research was carried out in 2012 and 2013 through an online survey. The selection of survey respondents was random – invitations to the study were sent via e-mail. Over 100 electronics stores took part in both studies. As stores operating in the dropshipping model were considered those which declared not having a warehouse.

The idea of dropshipping

Dropshipping is a method of selling products in which the seller does not physically store them. This method usually generates more profit per unit sold due to the cost savings that occur when retailers outsource the warehousing and distribution process. In a regular supply chain, the retailer buys the products from the wholesaler and stores them in their warehouse, then ships them to the buyer. When dropshipping is used, the products are stored in the supplier's (dropshipper) warehouse, which reduces the cost of shipping and cost of storage. And when the retailer gets an order on his online store, he then pays his supplier and the supplier ships the product directly from his warehouse to the buyer's address. This way, the product is not sent and stored at the retailer, which saves money and allows a decrease in product price and a higher profit to be made [2].

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In fact, where dropshipping is concerned, you are actually acting as the middleman for the product that your customer receives and the manufacturer who produces it. This particular type of system is extremely beneficial to both small retail shops, as well as internet based stores, or those people who use mailing catalogs in order to generate sales for their companies. In fact, many customers who purchase their products in this way seem not to be too bothered that there is a delay between the time when the products are ordered and when they actually have them arrived [6].

The biggest problem that is addressed by dropshipping is that retailers no longer have to worry about controlling their inventory, as this is done for them by the wholesaler instead. Unfortunately, in a more traditional retail setting, the products a store owner orders will be ordered in bulk, and they will then need to be kept in a secure location until they can be displayed and sold. What this means is that you are adding costs to an already large budget, as you will need to have storage space available, along with hiring staff to maintain the storage area and ensure that the goods are ready for delivery to the store and to know what levels each product is at. You will also need to spend money investing in a good quality security system in order to prevent the goods from being stolen. However, if you were to use dropshipping instead, then you would not need to retain a large stock of your inventory on site, and also you would no longer need to employ a large team of staff [5].

Some retailers also use drop shipment to test new products. Then, if the number of orders meets or exceeds expectations, the retailer can begin stocking the item. If the product fails to sell, the retailer can drop it without any associated costs. And if sales are mediocre-but profitable-the retailer can continue to use drop shipment to fulfill orders.

Apart from test items, other products that lend themselves to drop shipments include [3]:
- Perishable items, such as food and flowers, which cannot be stored in a warehouse.
- Large or bulky items which are expensive to ship. Rather than ship them from the manufacturer to the retailer, then to the customer, one shipment from the manufacturer to the customer saves on freight and reduces the opportunity for damage.
- Customized items that require the manufacturer to make alterations before the item can be shipped.
- Unusual or non-commodity items that a retailer does not receive a lot of orders for, but still wants to carry to fill out a product line.

![Dropshipping scheme](image)

**Fig. 1. Dropshipping scheme**

*Source: Robert Froyk, The ABCs of Ecommerce and Dropshipping Success: Practical guide how to start and run a successful online store and ecommerce business, Robert Froyk, 2012, p. 2*
As you can see in Figure 1, dropshipping is a really convenient way of selling online. When a buyer places an order on your online store, you contact your supplier (dropshipper) and tell them which product to send, give them the buyer's shipping address and pay them the product cost while keeping the remaining money as your profit (the difference between the amount the buyer paid you and the amount you paid the dropshipper). Then your supplier (dropshipper) ships the product to your client and gives you the tracking number and later, you give the tracking number to your buyer [2].

Once a retailer decides that dropshipping is the route they want to take, they need a plan to make sure the relationship with the vendor is managed correctly. On the front end, retailers need to make sure they are getting the right information from a vendor with regard to changes in product description, price and availability. It is easy for vendors to forget to inform the retailer about minor changes to the product and as a result, customers may be disappointed when they receive items that are not exactly the way they were described on the retailer’s website.

It is important for the data transmission to be efficient and above all fast. Thanks to the process described above, it is done automatically, with virtually no human intervention. The end customer does not feel the difference in handling between a traditional online store, and acting in the dropshipping model.

Although dropshipper plays a key role in the process of ordering and shipping of goods, it is completely invisible to the end customer. The package shows only return address and the logo of electronics store where the customer has purchased. If the customer receives the wrong shipment, they will send the complaint to the e-shop, which will then report the mistake to the supplier about the wrong shipment so that the supplier will send another, proper shipment.

**Polish dropshipping**

Polish experience in the use of this business model is little. On the basis of own research conducted in 2012 and 2013 through an online survey on a sample of more than 100 electronic stores it can be said that dropshipping was used by 24% of e-shops in 2012 and 14% in 2013. This is due to the fact of not having warehouses, and the need to find solutions that could fulfill this function (Fig. 2).

![Fig. 2. Online stores warehouse space in 2012–2013](image)

*Source: own research*

Among electronics stores that do not have the warehouse more than 27% of virtual stores is based on a typical logistic model of dropshipping, acting only as an intermediary between the customer and the distributor, which completes and sends the shipment. Other e-shops use a hybrid action-after they receive an order from a customer, they first make a purchase of goods and then of shipping, as shown in Figure 3. In this way, online store maintains control over the logistics processes.
The condition necessary for the existence of this model on the market is the existence of suppliers, the so-called dropshipping warehouses that will be interested in selling the goods offered in such model. According to G. Chodak, currently in spite of an increasing interest in dropshipping on the Polish market, there are few warehouses successfully applying this business model [1]. However, based on personal research it can be concluded that in recent years the number of dropshipping wholesalers is growing rapidly, as nearly 8% of e-shops declared cooperation with more than 50 suppliers. Over 60% responded that they restrict cooperation to a maximum of five partners, and another 20% to ten (Figure 4).

G. Chodak also mentions that Poland lacks wholesalers offering dropshipping model for a wide range of industries [1]. Although the authors of the paper did not carry out the analysis of industry suppliers for electronics stores, on the basis of staff e-shops it can be concluded that the implementation of dropshipping is most relevant in the house and garden (22%), followed by clothing and footwear (17%), and in third place followed by office, industrial, and children (11%). The results also confirm that the stores act as middlemen in the dropshipping model in micro and small enterprises. 69% of surveyed e-stores are one-man operations, and a further 27% employ fewer than 10 employees. Outsourcing of logistics functions contributes to the reduction of employment in the electronics store, and also limits the obligations of employees only to the current communication with customers and extensive promotional activities in order to attract the customer and maintain and create their loyalty by providing them with value, which is expected when shopping the virtual market.

For online customers, the factor determining the value through buying on the Internet, in addition to the often attractive price, lower than in a stationary store, is time saving. These advantages are con-
connected not only with the ability to place an order quickly, but also with the logistics, the goal of which is to provide the ordered goods to the customer as soon as possible. Therefore, more than half of e-shops transmit their order information to suppliers daily, 22% several times a week, and exactly the same number once a week or less. Impressive is the speed of execution of the contract, because in 6 of 10 cases the shipment occurs within 24 hours since the receipt of the order from the customer, in 22% of cases the execution of the contract lasts no longer than 48 hours.

Fig. 5. Assortment size of online shops
Source: own research

In the marketing concept of value for customer, the assortment size of e-shop is another determinant of its creation. A wide range of products allows the customer to satisfy their needs using the services of one virtual store, and therefore not turning in the direction of competition. Every fifth electronics store has on offer from 100 to 500 products, nearly 40% of respondents have 500–2000 assortment items, while every third store offers up to 10,000 different products, which are presented in Figure 5.

In the context of electronic commerce dropshipping boils down to the permanent cooperation between enterprises, based on business partnership, which involves transferring to subcontractors a large number of tasks related to the process of physical distribution.

Literature defines enterprise partnership as relationship between independent entities, arising out of their entrepreneurial spirit of the market, based on mutual trust, commitment and responsibilities of the parties that have decided to work together in order to achieve specific and lasting benefit from their cooperation. It should also be emphasized that the feature attributed to the partnership of enterprises is the fact that with the passage of time the parts of the cooperating system form strong and extensive social, economic, service and technical bonds.

Conclusions

In 2013 compared to the year before, the interest in e-business model using dropshipping definitely diminished. In 2013 the new stores were only slightly more than 10% of all stores operating in the system of logistics outsourcing, which is about 20% worse result when compared to 2012. The number of stores with seniority from one to two years also decreased by nearly 10%. It seems to be dealt with best by the stores that started dropshipping at least three years ago, at the time when the trend of conducting e-commerce without the constraint of having warehouses came to Poland. These companies have solid and reliable suppliers and experience in sales as an intermediary, which allows them to function efficiently.

Dropshipping as a form of outsourcing logistics may be used both in small and large e-stores. This model allowed many e-businesses for rapid development due to the reduction of costs, including labor costs and the construction or rental of store. Logistics services are distinguished on the outside, which gives companies more flexibility in the market and allows them to focus on core activities, including strategic activities.
The dynamic development of the model in the forthcoming years will probably change the face of Polish e-commerce. It is expected that the chances of development in the dropshipping field will be noticed by large distribution companies and logistics forms such as freight forwarders, previously uninvolved in e-commerce, having excess storage space and flexible logistics.

Abstract

Dropshipping is a logistics model of internet sales where the process of shipment is transferred to the supplier. The aim of the article is to analyze the dropshipping model with the characteristics of its actions and to determine its advantages and disadvantages. The theoretical part is based on Polish and foreign literature and enriched with secondary research results and the author’s own on the functioning of Polish electronic stores in the presented system.

Keywords: dropshipping, electronic stores, logistics model

References