



Drop-Shipping Overview

Purpose

Before getting into how drop-shipping works in Amazon, it is important to know what drop-shipping is and how it works. This lesson will cover those details.

Defining Drop-Shipping

Definition

Drop-shipping is a form of distribution in which the manufacturer or wholesaler sends the individual orders directly to the consumer for retailers (such as yourself). This basically skips the step of the manufacturer or wholesaler sending the retailer bulk orders for the retailer to then distribute individual customer orders.

The main benefit of drop-shipping for the retailer is that it allows the retailer to serve individual customer orders without ever carrying or touching the inventory.

To make this clearer, it is worth noting the various business entities involved with product acquisition and distribution:

- **Retail** – a retailer is someone who is able to provide a location for storing and selling the product directly to the consumer. The retailer purchases the product either directly from the manufacturer or from a wholesaler. A consumer is able to visit the retailer to select the product to be purchased, pay for the product and then take the product with him/her. An example of a retailer would be your local corner store or department store such as Wal-Mart.
- **Wholesale** – a wholesaler is one who purchases the product, usually in bulk quantity, and sells it to a retailer. The consumer rarely deals directly with the wholesaler, instead purchasing and acquiring the product via a retail outlet. An example of a product that is handled wholesale would be something like Europa Supplements, which is retailed through such outlets as Gold's Gym.
- **Manufacturing** – a manufacturer is the entity that produces the product. This is typically done by taking raw materials and converting them into products which are then sold and shipped to a product distributor (e.g. retail or wholesale) or sold by some means (e.g. online shopping) and shipped directly to the consumer.
- **Drop-shipping** – as mentioned under 'manufacturing', drop-shipping is the means by which a consumer is able to acquire a product he/she has purchased. The purchase may be made through a retailer or other means (e.g. online) but the product is shipped directly to the consumer rather than picked up at some physical location (e.g. retail outlet). More detail on this will be covered later on.



Distribution Models

In this section we will cover a comparison between the *normal distribution* model and the *drop-shipping* model.

In a *normal distribution* model, products make their way into the hands of the consumer as follows:

1. the manufacturer creates the product
2. the product is stored by a wholesaler/warehouse
3. the product is sold by a retailer
4. the consumer visits the retailer to purchase and acquire the product

In this model, there may be some variation as to the flow, but essentially this is how the product moves from manufacturer to the consumer. Also notable is the fact that the product may be manufactured and/or stored and/or retailed by the same entity. For example, the manufacturer may create and store the product until selling it to a retailer or a retailer may have its own wholesale/warehouse storage facility.

In a *drop-shipping* model, products make their way into the hands of the consumer as follows:

1. the manufacturer creates the product
2. the product is stored by a wholesaler/warehouse
3. the consumer purchases the product from the retailer
4. the retailer places an order with the wholesaler/warehouse or manufacturer
5. the product is shipped directly to the consumer

So in this model, the retailer is not required to have product on hand nor is the consumer required to visit the retailer to acquire the product.

Benefits and Drawbacks of Drop-Shipping

As with any model, drop-shipping has its advantages and disadvantages. The following will go into some detail on that.

Benefits of Drop-Shipping

Some of the benefits of drop-shipping are:

- **Low startup cost** – since the retailer no longer has to store inventory, the startup cost is much lower than for the conventional retailer
- **Larger products list** – another benefit of not having to store inventory is the ability to offer a greater number of products



- **No inventory system** – while there is still something of an inventory system in a drop-shipping business, it is greatly reduced from the size and complexity of a conventional inventory management system. With drop-shipping, you would only be responsible for your product list rather than managing inventory location, pricing, etc.
- **Reduced costs** – because you don't have to have shipping staff, a warehouse, inventory insurance, etc., your business costs go way down
- **Automation** – by outsourcing and other automation techniques, you can greatly reduce the amount of time you need to be involved with the process of doing business. So, for example, if you want a 4 day work week or reduced hours per work day, this method of doing business can be made to fit that desire.
- **Larger products list** – yes, this was already mentioned but it is worth mentioning again. Because you don't have to worry about these other costs in time, money and space to follow a conventional business model, you can focus on providing more and more items to potential customers. With more products to choose from and no real cost to you to provide them, you're able to appeal to a much larger customer base and, as we all know, more potential customers means more potential profits!

Drawbacks of Drop-Shipping

As with any system, there are drawbacks. With drop-shipping, the drawbacks are:

- **Distributor Reliability** – this is one of the highly critical points of drop-shipping, especially with Amazon. If you have products that don't get shipped out, don't arrive at the right place, don't arrive on time, run out of stock, etc., it can really hurt your reputation with potential or existing customers and, in context of Amazon, impact your account relationship with Amazon. Amazon does not want to deal with anything that hurts its integrity as a company, so if it is seen that you are not using reputable distributors for products you are selling through Amazon, they will cut you off or at least suspend your account until the problem can be corrected.
- **Reduced Packaging Control** – this can be an important point if you want to provide marketing materials, etc. in your shipments, the lack of control here can be a real drawback. It is possible to work out a deal with some distributors to provide marketing materials, coupons, etc. but you'll find that, for the most part, you'll not be very successful.
- **Cost** – when you have a storage location for inventory, your per-unit cost can be decreased as you are often able to buy at a bulk discount. With drop-shipping, this option is not available since in most cases your purchase is a much smaller number of units, preventing you from passing on those savings to buyers and thus potentially increasing your sales.



Conclusion

So as you can see, there are great benefits to drop-shipping both from a distribution model point of view and from a business point of view. In the following lessons we'll go more into how this model, drop-shipping, can work for you within the context of an Amazon partnership.