Introduction

Let’s say your company is physically located in Atlanta, Georgia and you have two Internet buyers getting ready to check out at your on-line store. One is located in Seattle, Washington and the other is in Memphis, Tennessee. They are both buying the same products weighing 5 pounds and they both need it overnight. You use a single carrier to deliver all of your orders.

I bet you can guess which one will buy from you (Total Price) and which one will be buying from their local brick and mortar retailer (Local Price). This guide is designed to help you rethink how you deal with shipping charges so you can combat these types of issues.

Almost every day I hear from a company that wants an easy way to add shipping charges to their Internet orders. This is mainly because that seems to be an easy way to deal with a variable cost – just pass it off to the customer. In addition, the carriers make it sound like finding a shipping charge is as simple as looking it up on a table. Think again.

Making customers pay shipping costs is traditional for most US companies, so it must be the right thing for businesses on the Internet, right? Many Internet companies are now realizing it is just not that simple and it is time to rethink this whole process. One thing I know from my studies of this field is that if you are going to close more sales, you must make sure the way you charge for shipping matches your customers expectations without killing your profits.
This guide covers the basic ways to charge for shipping, how to implement them and the pros and cons of each method. It turns out there are really only three basic ways to deal with shipping costs even though you can use combinations or variations of them in your total offerings. The three basic ways are:

- Charge the actual shipping charges
- Charge a flat rate
- Offer free shipping

What many have yet to realize is that shipping charges can become a tool to create more sales rather than something that causes shopping cart abandonment before the order is completed. Everyday, I hear someone say they do not want to make money on shipping so they just want to use actual charges. Making money from shipping is not what we are going to show you in this guide. In fact, it is not a good idea anyway unless that is part of your company’s business strategy. Instead, I am going to show you how to properly apply the right method for your business and show you how handling shipping charges correctly can help sell more goods and services. My ideas may even stimulate more of your customers to come back to buy again, again and again.

The following sections discuss each of the three basic ways followed by a final section where I summarize all three ways and discusses the best way to precede. I suggest you read all the sections in order before reading the final section. This will give you a complete understanding of each method and how they should be used. It will also help prevent making the mistakes many make every day.

As with so many other things that have changed recently by the leveling effect of the Internet, it is now time to rethink how to deal with shipping costs. Those that do not deal with them correctly for their business will find the old ways could actually make them lose business and pay way too much getting their products to market.
Actual Shipping Charges

The most common mistake people make when handling shipping is to charge the customer exactly what the carrier charges them for shipping the orders. This may sound good on the surface but the pitfalls make this very hard to do in practice. In fact, doing so can be devastating to many Internet businesses. Let’s explore some of the problems of using this method.

One of the big problems is getting the actual charges, and not a low estimate, at the time of shipping. Many shopping carts have either integrated or provide programming links to shipment rating engines. There are two problems with this in practice. First, the rate may not be completely accurate. Most of these services do not take into consideration things like volume discounting. But you say that is O.K. because that is in your favor. That is true for discounting, but most rating services and tables do not take into consideration things like fuel service charges, residential surcharges, address correction, shipment notification, return services, additional charge carrier services, parcel insurance and many other after-the-fact charges that can in total be more than the basic shipping charges!

The second problem can arise from the programming costs that are needed to initially install the rating service, tools or API’s to your shopping cart web site. There are also the issues of keeping them up-to-date as carriers and services change. Carrier changes can happen multiple times throughout the year with as little as 30 days notice. This can be a major expense to implement and late updates can result in you charging the wrong shipping amounts.

So you say that does not matter, you are willing to be close to the right price, and you do not mind the cost to install or maintain the rating service. This too is an interesting statement I have heard in the past, but this is not something I would agree with for the real Internet retailer. There is a second problem that is much more serious - shopping cart abandonment rates. Using actual shipping charges can actually be making you lose sales! Let me explain.

Somewhere in our not so distant past it was generally accepted that the buyer located farther away would pay more than those close by. The problem with Internet retailers is
that we have now become a global market where buyers and sellers can be located anywhere in the world. It has been described by many that the world has become a flatter place to do business, so we now work like everyone is local. You say you only sell domestically? Let me let you in on a little secret. You have the same issue when selling on the Internet. Smart Internet sellers know if they are to compete with local brick and mortar stores they must be competitive in price down to the final submit order button. Let’s go back to our initial illustration. The following map illustrates the shipping cost across the United States for your 5 pound product. You can see what each of these two customers would pay for shipping when using actual shipping charges from a single carrier. Which do you think will be more likely to abandon their shopping cart before clicking to submit the order?

How bad is this problem? The U.S. retail e-commerce sales estimate for the fourth quarter of 2006 was $29.3 billion, an increase of 6.3 percent from the third quarter of 2006, according to the Census Bureau of the Department of Commerce. Those numbers indicate continued steady growth but did you know that 50-70% of shoppers abandon their shopping cart order before they complete it? In addition, 56% of those that leave do so once they know the shipping charges!

Even worse is the fact that the further the distance between buyer and seller, the higher the abandonment rate when using actual shipping charges. As shipping charges get higher, it increases the chance that the order will never be completed! Do you plan to sell products to only those located close to your business? Use actual charges and cart abandonment can happen to you regardless how well you market your product over the Internet.
The only time charging actual shipping charges really makes any sense is for heavy items or when a discount can be passed to the buyer when they buy in pallet or truckload. Normally this rules out most Internet retail shippers.

Therefore, today’s Internet retailers must rethink the use of actual shipping charges in most cases. Shipping charges must be handled like all components of a good shopping cart system. It must be the easiest thing that the customer does that day. For this reason charging actual shipping charges is not the appropriate thing to do in all but a few cases. Instead, you should consider either charging a flat rate shipping charge, or including your shipping charges in the final price to create a free shipping offer to optimize the customer experience. The next two sections explain how to decide which is best for you and how to make them both work to help you sell more products.
Flat Rate Charges

In the previous section, you saw that charging actual shipping rates potentially increases shopping cart abandonment and lowers sales. So you say, “Why charge anything at all?” I would tend to agree from what has been said so far, but I have found there are times where charging for shipping should be considered. In this section I will discuss the reasons to use flat rate charges or a variation. I will also discuss how it should be implemented so that it will help you sell more products.

The first step is to determine the initial flat rate charge amount. If you use a carrier that uses a single rate, that is great. Most times this is not the case since there is a big difference between Overnight, 2-day, 3-day and Ground shipping service charges. The first thing to decide is how quickly customers will want to receive the orders. Once you determine the shipping methods to be used by your customers, you will need to look at the carrier rate tables and determine the high, low and average charge for each method. Most carrier rate tables use weights and zones to determine their rates. You will need to add all the rates for all the zones at the weight of your goods and divide by the number of zones. For example if you are located in the US, you decide to offer Overnight and Ground shipping for all your US orders, and your orders weighed 5 pounds at the time of shipping, you would make the following calculations:

**For Overnight Shipping Method**

High Charge: $46.90  Low Charge: $20.80  Average Charge: $24.96

Carrier A:

($20.80 + $26.30 + $36.90 + $40.40 + $44.50 + $45.20 + $46.90) / 7 = $37.29

Carrier B:

$25.65 (All Zones)

**Best Rate: (Carrier A for First Zone and Carrier B for All Others)**

($20.80 + $25.65 + $25.65 + $25.65 + $25.65 + $25.65 + $25.65) / 7 = $24.96
**For Ground Shipping Method**

High Charge: $7.01   Low Charge: $4.48   Average Charge: $5.05

Carrier A:

\[
\frac{($4.48 + $4.73 + $5.49 + $5.72 + $6.09 + $6.34 + $7.01)}{7} = $5.69
\]

Carrier B:

\[
\frac{($4.21 + $4.69 + $5.29 + $5.43 + $5.64)}{5} = $5.05
\]

**Best Rate: (Carrier B for All Zones)**

\[
(\text{All Zones}) = $5.05
\]

This example considers the rates of two similar carriers and carrier shipping methods. For the Overnight Shipping Method Carrier A uses shipping by zones where Carrier B has a flat rate for all zones. When shipping to the first zone Carrier A is the best choice but when shipping to the other zones Carrier B is better. In coming up with an average charge for the Overnight Shipping Method, a mixed Best Rate calculation is made for all the zones and then averaged. This gives you some padding in your average charge to help you cover for the time you shipped to the first zone using Carrier B by mistake or for some other reason.

For the Ground Shipping Method all, zones were better using Carrier B so you would just use the average charge for its zones. It is important that you check the average charge for all weights you plan to ship as these calculations will vary for different weight and zone destinations. Do not assume that just because the result came out this way for one Carrier that it will be the same result across several different combinations.

When you first start shipping you may not have a shipping history to help you determine how much your actual average shipping charges will be. Therefore you can use the above calculations to make an educated guess. The more profit in your product sales amount, the lower the risk you will be taking in setting the initial shipping charges at average amounts. You should attempt to break even on shipping charges as this will be closer to what customers expect. Therefore, the average charge should be closest to break even if you anticipate your sales to be evenly distributed geographically and if the high and low figures are not too widely spread. High profit products being shipped can more easily favor toward the average charge where low profit products should favor the high charge figure. The higher your volume, the closer you should be to the average charge. The best idea is to round up to the nearest dollar using the average or high charge figures when coming up with your flat rate for each shipping method. Just remember the lower you can make the figure and the closer it is to break even in total every month, the more likely you will meet customer expectations. If you feel there is too much risk, you can always set an initial charge between the average and high charges and adjust as your actual shipping charge data starts to accumulate. The important thing is to make sure that, in your worst case, you still break even.
To stay at the correct flat rate, you will need to keep track of the number of packages, the shipping costs and total weight each day, organized by shipping method used (overnight, ground, etc…). After you ship for a month, you can use these figures to determine how close your initial flat rate charges are to actual costs and how much they need to be adjusted. This is something that should be reviewed monthly. It is also important for you to make sure you are accounting for all the additional charges when you make your initial calculations and when you do your monthly reviews. To check for uncovered charges at the time of shipping, you should also compare the charge totals recorded by your shipping system against the actual billed amounts.

This all sounds like a lot of work when you start shipping in volume, but it can be done automatically by readily available shipping software. It should also be noted that using shipping software that supports multiple carriers can lower shipping costs by automatically choosing the best rate between different carriers with like services. Shipping charges are constantly changing and can vary a lot between carriers even from month to month. To get the lowest shipping charges you need to check for the best price for the weight and destination for every package you ship. Today, most multi-carrier shipping software can do this all automatically. Shipping software can also lower your costs by doing address correction and help you keep track of and control additional charge services as they occur.

The main thing is to do everything you can to optimize your shipping costs. Lowering your actual shipping cost will help you lower your flat rate figure which can be passed to your customers. The lower you can make this figure, the lower your prices can be. Customers will like to do business with you and they will finish that order if your flat rate shipping amounts are low.

Once you determine the correct amount for your flat rate shipping charges, the next step is to utilize this information to optimize your sales. If you are trying to increase the amount or number of items a buyer purchases, you can use the average charge figure to help sell more products. The best way to do this is to offer your customers the chance for free shipping. To do this you would use your flat rate charges for single purchased items or total shipments under a certain dollar amount, but once a certain volume or amount is reached the shipping costs would be dropped. Free shipping will be discussed in the next section in further detail. The main thing to consider is to make sure at all times you break even on total shipping charges. Now that you know how to start using flat rate charges and continue to adjust them means that you can do exactly that. If you do not think this is a good idea, check out some of the successful Internet shippers like Amazon.com to see what they offer for shipping. Charging for shipping using a flat rate is proven to reduce shopping cart abandonment.
The follow map demonstrates the difference in our illustration when using flat rate charges from multiple carriers instead of actual shipping charges from a single carrier.

Flat rate shipping may be all you need to change to increase your sales and market share.
Anyone who is in business very long knows that if you have a product people want and you provide some type of “Free” offer, sales usually increase. The big question is if you are still making a profit after all is said and done. For this reason, the first thing you must calculate is if you can still make a profit if your flat rate shipping charge amount is subtracted from your selling price. If this is the case, it might be worth considering offering free shipping to not only increase sales but to further decrease shopping cart abandonment. But, free shipping should only be used to increase profits overall.

If free shipping is not a good choice because it will damage your overall profit, there are some changes you might want to consider before thinking it is not for you.

First, if you are selling below market and your price remains competitively low after adding the flat rate amount, you should consider adjusting your price by adding the flat rate. This will allow you to offer free shipping without losing profits.

Second, if you are using just one carrier for all your shipping, you should consider using a multi-carrier shipping system to shop around for lower cost ways to get your products to your customers. The difference between carriers’ pricing can vary a lot for the same delivery times and locations. Shipping charges can vary from carrier to carrier for each location you ship to. A multi-carrier shipping system can help you lower your shipping charges by automatically price shopping. Lower cost shipping methods allow you to lower your flat rate charge, which lowers the bite it takes out of your profits if you decide to offer free shipping.

If you can lower your shipping and other costs when you sell more products to the same customer, you might want offer your free shipping for volume orders. This can work for you in two ways. First, you cover your shipping costs and still make your profit. Second, it entices your customers to purchase more. This is the most frequently used method by most successful Internet shippers when using a free shipping offer.
If you think some of your customers are not going to want your free shipping offer because you use a slow method of delivery for free shipping of volume orders, this can work in your favor too. Since you have already added the cost of your lower cost flat rate charge to your product price, you can offer your expedited shipping method as an upgrade for its normal price less the lower cost flat rate. Doing this can make paying for shipping look like a deal to the customer and at the same time help you close the sale.

In the Sources section of this document I have added several articles that discuss and elaborate on these ideas and principles. I highly recommend reading some if not all of them.

Free shipping is a great tool to increase sales when used properly. It is very important that how it is used is carefully evaluated before it is employed to insure a continued profit.
Summary

Internet sellers should avoid using actual shipping costs unless they have widely varying charges due to broad weight ranges for orders, or they ship very heavy or oversized products. Using actual shipping charges can cause the Internet seller to limit their market size to those located close by due to high shipping costs for further distances. This causes shopping cart abandonment and other issues.

If you are selling single items, in most cases the flat rate charge method works best. It flattens the shipping costs to look the same for all buyers over a larger geographic area and it keeps you more competitive. The important thing is to monitor your costs monthly to make adjustments for changes in average charges. When using flat rate charges you can offer free shipping for special times of the year like holidays when competing for the consumers’ dollars. The main thing is to make sure you are making enough to break even for total shipping charges when you use a flat rate. It is also important to make sure you are making a profit when you offer free shipping specials.

When you look at customer satisfaction and shopping cart abandonment issues, one can come to the conclusion that free shipping is the only way to go. But, this may not be the best approach. Using flat rate shipping charges for low volume orders and using free shipping to increase the volume shipped can be a much more effective to increase sales, decrease shopping cart abandonment and increase your return customer rate. If done properly it also leads to increased profits.

One last point, it has been found by a number of experts and Internet entrepreneurs that it is very important to display shipping charges before checking out to avoid shopping cart abandonment. This is another reason to use free shipping or flat rate charges. Using free shipping or flat rate charges allows you to give shoppers shipping charge information without the need to collect any information about the customer. This is not possible when using actual shipping charges. This is yet another reason to use free shipping or flat rate charges for shipping.

I hope this guide helps you decide the correct way to deal with shipping charges, or at least gets you started. The most successful companies make shipping charges work as part of their overall sales and marketing plan to increase sales on the Internet. The important thing is to keep the on-line shopping experience as simple and fast as possible for your customers. There should be no hidden, last minute costs that cause them to leave before completing the order. Shipping charges do not need to be the reason they leave. They should instead be the reason they buy more.
Dos and Don’ts

The following is the “short list” to consider when setting your company’s policies for handling shipping of your products.

- DON’T assume that using actual shipping charges are what the customer expects and that they will only look at your product price before shipping.
- DO show your customers the amount it costs to ship your products early in the order process.
- DO keep track of your total shipping charges monthly and readjust your charges according to break even.
- DON’T try to make money on shipping charges.
- DO use shipping charges as a selling tool by offering flat rate and free shipping.
- DO use free shipping to increase your sales volume.
- DON’T assume that all carriers charge the same amounts for shipping just because their published charts look the same at a glance. Make sure you consider additional charge carrier services. Look closer and do the math.
- DO consider using automation to help you better control your shipping costs.
Glossary of Terms

The following are the intended definitions of the terms use in this guide.

**Actual shipping charge:** The amount charged by the carrier. Many times it is implied to be the amounts found on carrier rate and zone tables. But these tables leave off the charges that will be realized at the time of the actual carrier billing.

**Additional charge carrier service:** The charges added to the actual shipping charge for extra services or value-added services. This includes services like Saturday Delivery, Delivery Confirmation, Shipment Notifications, Return Services, and other extra cost services. Some charges can occur after the time of delivery.

**Address correction:** The ability for software to correct the mistakes made in address information to help insure a greater probability of being delivered as promised.

**Carrier charges:** Shipping cost for delivering goods from seller to customer. It is usually calculated using the distance between the origin and final destination by package weight and other considerations.

**Expedited shipping method:** Shipping method faster than normal ground services. This generally includes same day through up to 3 days delivery time services.

**Flat rate charge:** A single charge for shipping a product or products using a single shipping method.

**Free shipping:** Selling product or products without charging any shipping charges to get the product from seller to customer.

**Fuel service charge:** Most carriers use an index-based surcharge that is added to monthly shipping charges. Changes to the surcharge are generally adjusted on a set frequency. Most adjust them monthly.

**Logistics:** The art and science of managing and controlling the flow of goods from the source of production to the marketplace.

**Multi-carrier shipping software:** A computer application that collects the shipping information, corrects the address information for proper delivery, optimizes the rating of shipments using multiple carriers according to shipper desire, and creates the resulting shipping labels and documentation to meet carrier requires for correct delivery of goods and their tracking. It also automatically handles communicating all the shipping information to the carrier with the minimum of shipper intervention.
**Oversize:** Packages being shipped that do not meet carrier specific dimensions and have an extra cost associated with being too large for their weight. This term is also known as dimensional weight.

**Parcel insurance:** Sometimes called Declared Value, is the extra cost for insuring higher value packages. Many carriers cover a fixed amount of value as part of the shipping charges. Third party services like PIP and U-PIC offer alternatives to carrier insurance.

**Return services:** Carrier additional cost services for returning packages to senders.

**Residential surcharge:** The extra cost for shipping a package to a residential location rather than to a commercial one. This is defined differently by many carriers.

**Shipment notification:** An e-mail or FAX sent to a given e-mail address or FAX number containing shipping, order and tracking information.

**Shipping method:** Different types of delivery services offered by carriers. These are used to categorize different types of delivery options when calculating and offering flat rate shipping rates.

**Shopping cart abandonment:** Shopping cart orders not completed because the customer exits the Internet store before completing the order.

**Supply chain:** Logistics network that is a coordinated system of organizations, people, activities, information and resources involved in moving a product from supplier to customer.

**Zones:** The codes assigned to packages moving from one point to another in a time frame. These codes are usually used to determine actual shipping charges when combined with the weight of the package.
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Background of Author

One of Harvey Software’s founders, Bert F. Hamilton, is currently in charge of the company’s strategic planning, management and technology development as President and CEO. Currently, Bert is responsible for Harvey Software’s day-to-day operations. Over the past 23 years Bert has become experienced as a technology entrepreneur, software solutions innovator, logistics consultant, and developer of supply chain technologies. During his time at Harvey Software, Bert has helped thousands of shippers and parcel carriers, both large and small, solve their most difficult shipping and customer problems. His educational background includes business administration, computer science, mathematics, marketing research, marketing, sales and finance at Purdue University, Indiana University and University of South Florida. He has a BA from the University of South Florida College of Business Administration. In addition to his work at Harvey Software, he currently serves on the computer science review boards for Edison Community college and Florida Gulf Coast University. Bert actively serves on several local governmental advisory boards for both technology and community business development. Most of his free time is spent working on conservation and environmental projects.

Harvey Software, Inc. is a leading provider of business-to-business and business-to-consumer shipping software solutions for Internet and brick and mortar businesses. Harvey Software's innovative line of multi-carrier shipping software solutions includes products like the Computerized Parcel System (CPS).

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