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Same-Day Delivery

Not Yet Ready for Prime Time

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AT A GLANCE

Retailers and carriers are piloting the same-day delivery of goods online, a concept that originated in the dot-com era.

Consumer Demand Is Limited

A survey of 1,500 U.S. consumers shows that they care more about low-cost merchandise and free delivery and returns than same-day delivery.

Segmentation Is Required

Despite limited overall demand, "affluent Millennials," a narrow slice of the market, represent a potentially attractive consumer segment.

Competitive Pressures

Retailers and carriers say they feel compelled to respond to threats from online competitors and a new generation of startups offering same-day delivery.

Test Drive

To maximize the potential of same-day-delivery, retailers and carriers alike should test geographic markets, price points, delivery windows, and other elements of the endeavor before making a huge commitment.

SAME-DAY DELIVERY, A CONCEPT that bombed during the dot-com era of the late 1990s, is back on the loading dock. Major retailers such as Wal-Mart, Nordstrom, eBay, and Amazon.com are all offering same-day delivery in a limited number of locations. FedEx, UPS, and the U.S. Postal Service are partners in these pilots.

Like so much else during the dot-com era, same-day delivery was not ready for prime time when it was first offered. Kozmo.com, the best-known same-day carrier of that era, became a poster child for the excesses of the dot-com boom. Today, same-day delivery has returned—with a new set of propulsive forces. The online retail market is now much larger. Traditional retailers are under pressure from online shops such as Amazon to offer fast delivery, and carriers are facing competition from upstart same-day companies such as Shutl, Zipments, Instacart, and Postmates. In conversations with BCG, executives at retailers and carriers said that they feel compelled to respond to these threats. But does it make sense to do so? To get a better understanding of the potential for same-day delivery, we surveyed 1,500 U.S. consumers about what would cause them to buy more online.

Most consumers care more about low-cost merchandise and free delivery and returns than same-day delivery. That central finding of the survey suggests that retailers and carriers will need to carefully segment the market by customer, product, and "buying moment" in order to make same-day delivery work. In creating mass-market strategies, retailers would be better off focusing their efforts on improving other aspects of their multichannel offerings, and carriers should focus on creating seamless and enhanced delivery and routing services while they beta-test the operating requirements and revenue benefits of same-day delivery.

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Consumer Demand Is Limited

In the survey, consumers ranked same-day delivery eleventh on their wish list of improvements. (See Exhibit 1.) More generally, expedited services are not in high demand. Only 3 percent of survey respondents said they currently choose next-day delivery most frequently. An analysis of the survey data suggests that same-day delivery, if not offered for free, would be used for less than 2 percent of all online purchases.

Moreover, even in the limited circumstances in which consumers are amenable to same-day delivery, the majority said that they would only be willing to pay $6 to $10 to receive a $50 purchase. (See Exhibit 2.) This range is less than the $10 to $15 that most retailers currently charge and would make the economics of same-

EXHIBIT 1 | Free Delivery and Lower Prices Are More Important to Consumers Than Same-Day Delivery

Sources: BCG survey of 1,500 consumers in late 2012; BCG analysis.
Note: Percentages include the top three choices made by respondents.

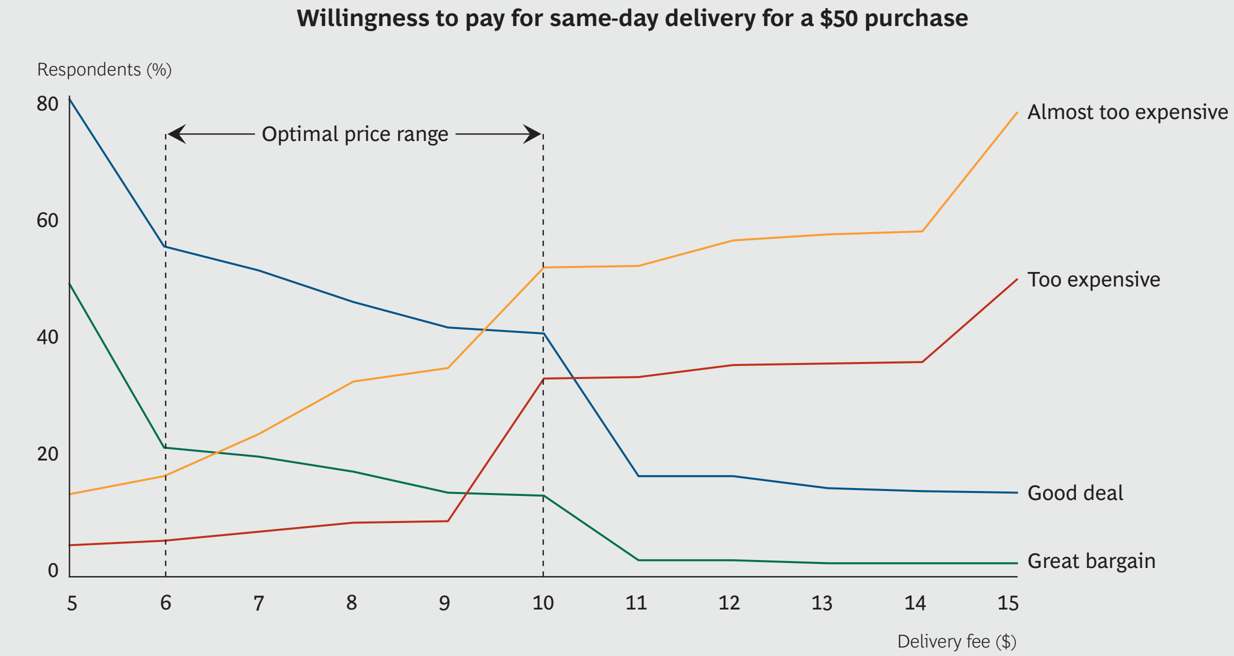
day delivery will be challenging for both retailers and carriers. In addition, the amount that consumers are willing to pay varies depending on the type of product. More than two-thirds of respondents said they would pay $5 or less for the same-day delivery of books, music, and beauty and health care products. But consumers show a greater willingness to pay higher same-day delivery fees for larger and more expensive items such as furniture, appliances, and computer electronics.

Consumers do not frequently feel the need to receive a product on the same day that they purchase it. In response to the question, "On what occasions would you use same-day delivery?" a narrow majority, 51 percent, cited last-minute gift purchases—suggesting that the service would be an ad hoc option for most consumers.

Not a Mass Market, but an Intriguing Segment

In 2013, same-day delivery could conceivably generate between $425 million and $850 million in delivery fee income. That estimate assumes that consumers are willing to pay shipping fees of between $6 and $10 per purchase and that up to 2 percent of all orders are delivered on the same day. Offering the service at this price will leave very limited margin for retailers and parcel carriers. For the carrier industry, which generates $70 billion in annual revenues from parcel shipping, the

EXHIBIT 2 | Most Consumers Consider $6 to $10 a Fair Price for Same-Day Delivery



Sources: BCG survey of 1,500 consumers in late 2012; BCG analysis.
Note: The optimal price range is determined through the Van Westendorp pricing methodology.

projected revenue from same-day shipping is relatively modest—especially for the big companies. Thus, same-day delivery will likely remain a highly segmented niche market in the absence of subsidies from carriers or retailers. In any scenario, carriers and retailers will have to play large roles in creating, shaping, and energizing the service.

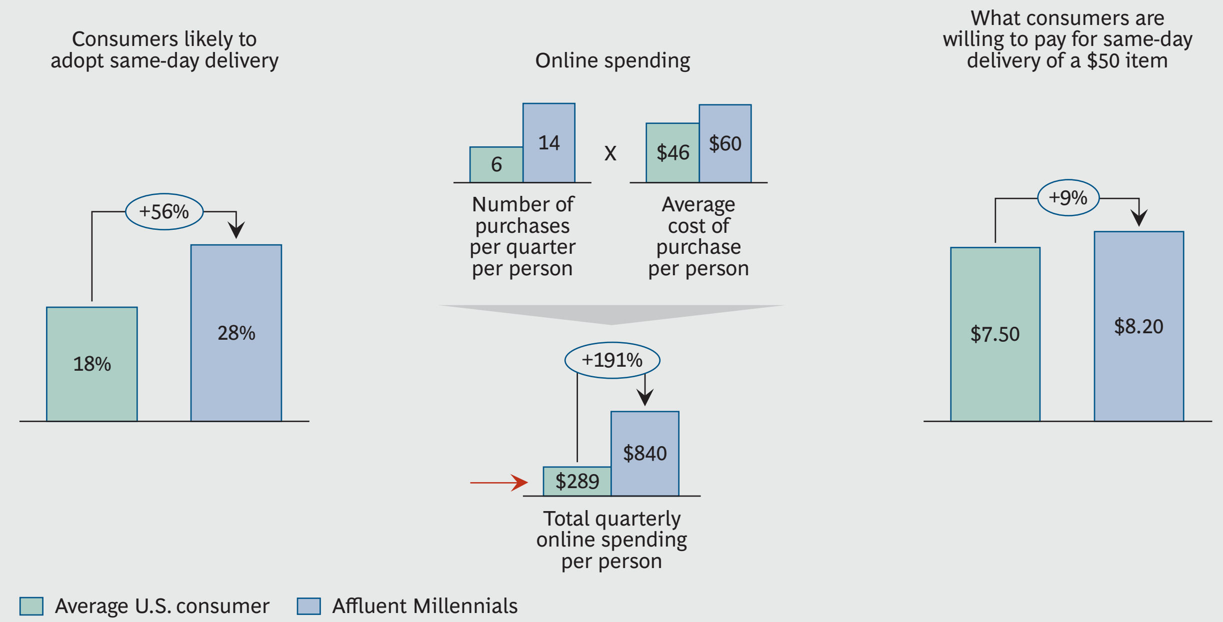
The best way to start trying to create market demand is to target the "affluent Millennials"—consumers aged 18 to 34 with household incomes exceeding $150,000. Affluent Millennials are 56 percent more likely to purchase same-day delivery than the average online consumer. (See Exhibit 3.) They are also big spenders, buying $840 worth of goods online per quarter per person, compared with $289 for the average online consumer.

The Soft Benefits of Same-Day Delivery

Despite the limited demand for same-day delivery, retailers and carriers are offering it as a pilot in selected markets. Their motivations may be slightly different, but both retailers and carriers view same-day delivery as an opportunity to provide collateral benefits to their customers.

Retailers aim to enhance consumers' brand perception. Even if the immediate economics do not justify offering same-day benefits, customer loyalty and the

EXHIBIT 3 | Affluent Millennials Show the Greatest Interest in Same-Day Delivery



Sources: BCG survey of 1,500 consumers in late 2012; BCG analysis.
Note: Affluent Millennials are consumers ages 18–34 with annual household income exceeding $150,000. They are concentrated in metropolitan areas. Forecasted adoption rates are based on BCG's experience with concept tests and are calibrated against actual market performance.

potential for an even larger share of wallet from top customers may make the service worth pursuing. Consumers, for example, say that they would be more likely to purchase from a retailer that offers same-day delivery as opposed to a retailer offering the standard window of five to seven days. Thirty-eight percent of survey respondents said that a same-day delivery option would have a very positive influence on their perception of an online retailer. By contrast, 16 percent said that the typical five- to seven-day window would have a very positive influence on their decision whether or not to make a purchase from a retailer.

It is hard to put a value on this potential "brand halo." Amazon Prime, a service that provides free two-day shipping and selected free video content for an annual fee of $79, for example, has helped quadruple Amazon's share of wallet with some customers. But it was not immediately apparent in 2005, when it was launched, that customers would be willing to pay for the loyalty program or that it would generate sales.

Carriers look to achieve competitive differentiation. Carriers should be viewing same-day delivery as one of a host of potential service enhancements, along with parcel tracking, dynamic rerouting, and the ability to pick up deliveries from parcel lockers. When these services are bundled together, the whole is greater than the sum of the parts. The same is true for same-day delivery. The service is unlikely ever to be a silver bullet, but it could be used to improve consumers' awareness and perception of the brand.

For national carriers, same-day delivery may also be a hedge against regional players and startups as they begin to gain scale. These smaller companies represent a potential threat in the markets in which same-day delivery makes sense. Smaller carriers, such as Dynamex, OnTrac, and Lasership, have started to make deliveries for Amazon, Barnes & Noble, and other retailers, while several other startups are offering urban courier services and could move into same-day deliveries.

Retailers and Carriers Should Test Specific Elements of Same-Day Delivery

Economics and history suggest that retailers and carriers should go slowly in developing same-day delivery services. Kozmo.com and other startups from the dot-com era scaled up quickly, investing in technology, distribution, and labor ahead of demand. Their revenues could not support their fixed costs. Today, same-day services appear, at best, to be a breakeven and loss-leader proposition that may be able to build market share and improve customer stickiness and perception. Here are some steps for retailers and carriers to take as they consider same-day delivery. (For a summary of these steps, see the sidebar, "Same-Day Delivery Checklist for Retailers and Carriers.")

Retailers should experiment with markets and offers. While same-day delivery could potentially be a standalone business for retailers, the greater opportunity is to use it to enhance customers' overall multichannel experience.

The most important decision for retailers is where to test same-day delivery. New York and San Francisco, which have suitable demographics and density for the service, are the sites of most same-day delivery experimentation. However, both cities have greater population density and different buying patterns from those of most of the other urban areas with high percentages of affluent Millennials, such as Austin, Philadelphia, San Jose, Seattle, and almost two dozen other markets that would provide greater overall opportunities for retailers to understand the viability of same-day delivery. Boston and Washington are much more representative of these other potential target markets. (See Exhibit 4.) Retailers should also choose test markets based on the availability of nearby inventory, either in warehouses or stores, for fulfilling anticipated demand.

Same-day delivery could potentially be a standalone business, but the greater opportunity is to use it to enhance customers' overall multichannel experience.

As part of their experimentation, retailers should test those products that can be delivered profitably on the same day they are purchased. These will likely be high margin, relatively small, and not readily available in neighborhood stores for most consumers. Electronics, office supplies, and apparel all qualify as strong test candidates.

If same-day delivery has a future, it is likely to be as part of a retailer's overall multichannel approach to improve the customer experience, generate loyalty, and increase market share. For select high-margin customers, same-day delivery may even serve as a way to demonstrate superior customer service. Retailers should be closely evaluating whether the offering helps to improve overall wallet share, frequency of purchase, and sales. They must also carefully evaluate potential

SAME-DAY DELIVERY CHECKLIST FOR RETAILERS AND CARRIERS

Carriers and retailers must be fully prepared before embracing same-day delivery.

Carriers

- Be able to execute basic parcel services reliably and at lower cost before offering same-day delivery.
- Maintain investments in other high-potential initiatives, such as delivery tracking, parcel lockers, and dynamic rerouting.
- Evaluate the investment return of same-day delivery based on its potential to increase wallet share of retail parcel traffic, to improve consumers' brand perception, and to mitigate threats from national, regional, and local carriers.
- Consider subsidizing delivery costs for retailers in exchange for a larger share of wallet.
- Invest in expanded capabilities to execute same-day delivery, such as establishing strategic partnerships with high-potential retailers, pushing the boundaries of network flexibility through low-cost labor and lean operations, developing or acquiring enabling technologies, and exploring partnerships to support execution and share costs.
- Pilot same-day delivery in representative markets such as Boston and Washington in order to gauge consumer demand, refine the offering, and test the capabilities of the operating model.

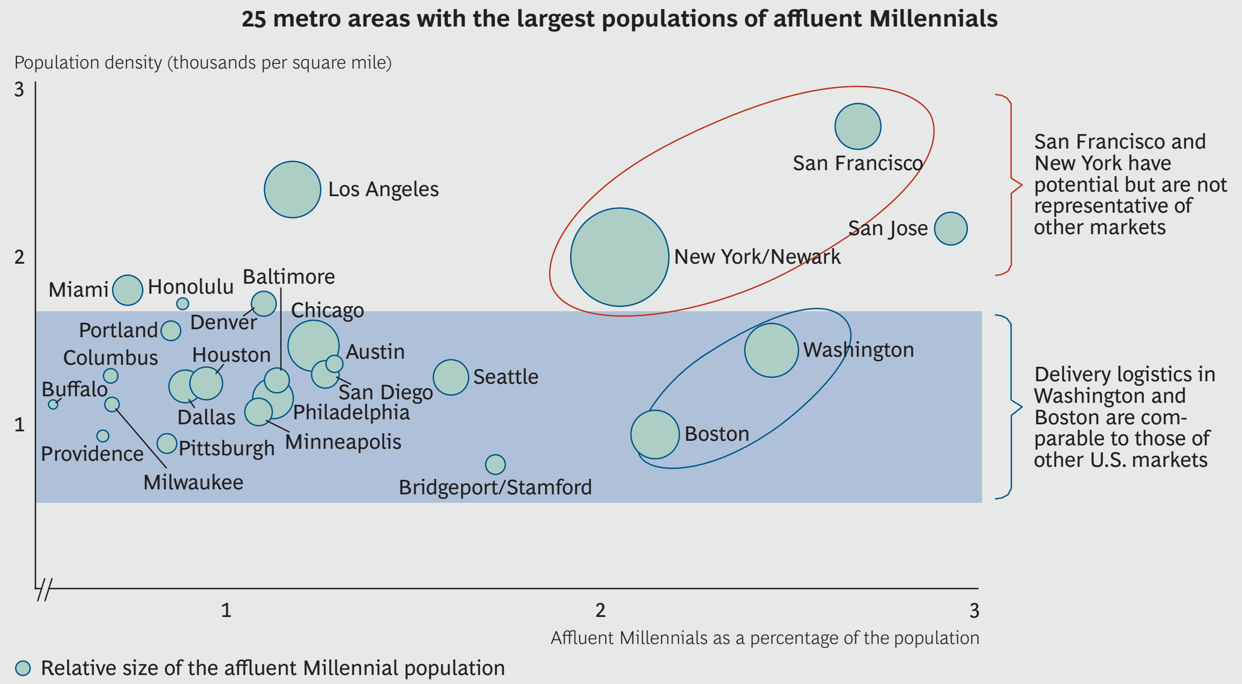
Retailers

- Analyze the expected costs and benefits of same-day delivery and have a clear path to increased revenues before jumping in.
- Articulate a clear strategy for same-day delivery, either as a standalone business or as an enhancement that will improve customer loyalty.
- Consider alternative approaches, such as cutoff times as late as 11 p.m. for next-day delivery and click-and-collect services that allow customers to order online and pick up goods in a store.
- Evaluate and select delivery partners based on their willingness to share the risks and on the sophistication of their fulfillment systems.
- Pilot same-day delivery offerings to understand demand; test the effect of cutoff times, minimum purchase size, delivery fees, and product categories on overall spending in different consumer segments.

delivery partners and rigorously test all aspects of a same-day offer: cutoff times, minimum purchase amount, delivery fee, and product selection.

Carriers need to test delivery models and build capabilities. Carriers are the tail of the dog in same-day delivery. They would not offer the service unless retailers wanted them to. But carriers should not follow retailers into an untested field

EXHIBIT 4 | Washington and Boston Are Promising Pilot Sites for Same-Day Delivery



Source: BCG analysis.

without establishing their own criteria for success. For the foreseeable future, same-day delivery is unlikely to be a game changer, so carriers—likely shouldering more operational and financial risks than retailers in the endeavor—should be cautious.

Carriers have a basic choice between two different delivery models. The first is an extension of their existing delivery network. Carriers would either extend the delivery time for receiving orders from retailers or pick up parcels directly from them. The orders themselves would be delivered to customers as traditional parcel shipments. This model works with somewhat urgent purchases, as the last-mile fulfillment process remains unchanged. It would be most effective for serving retailers with distribution centers located near a carrier's local sorting facility. The model would require extra operating capacity, particularly labor, to support extended drop-off hours and delivery windows.

The second model involves creating a separate network to support same-day delivery. Carriers would have to provide an on-demand delivery service from retailer warehouses or local retail stores. This model would allow retailers to fulfill their customers' desire for instant gratification, but it would only work in densely populated areas and would also require a large commitment of resources. Vehicles would need to be on call to respond, and retailers and carriers would have to establish a technology platform that enabled real-time route scheduling and parcel pickup. This approach is more costly, but carriers might be able to avoid some investments in labor, infrastructure, and technology through outsourcing—deploying local couriers, for example, to handle final delivery.

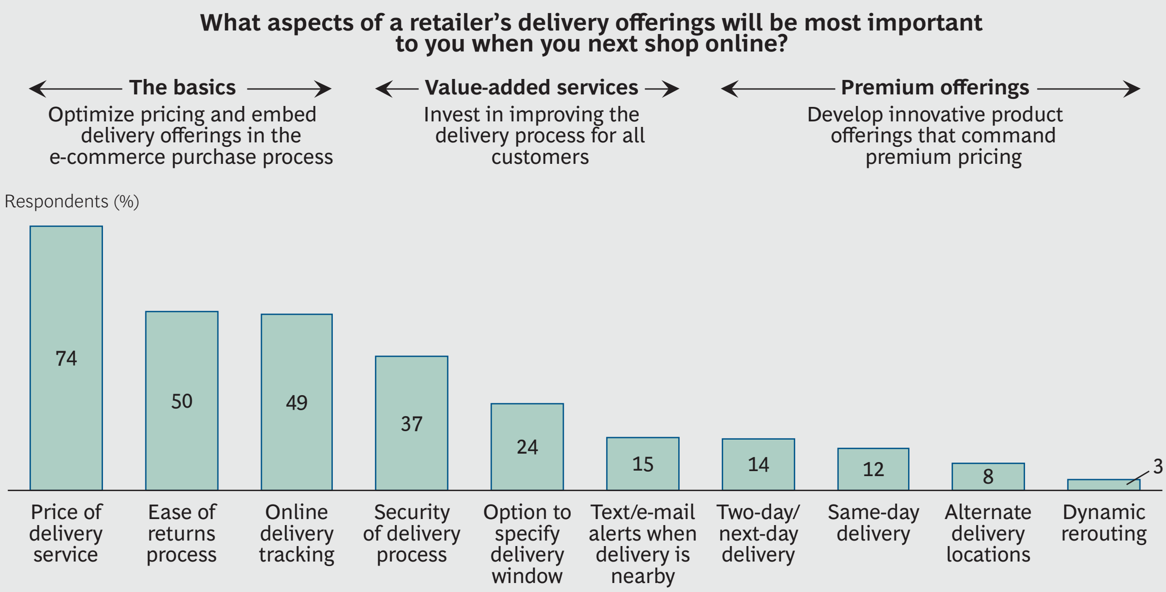
In order to execute same-day delivery, carriers will need to develop key operational-flexibility and routing-technology capabilities. They will need to build a flexible workforce that relies on contract-based or part-time labor. They will also need to develop partnerships with retailers in order to create a seamless and dynamic routing and delivery network. In some instances, it might make sense for carriers to subsidize the cost of same-day delivery in order to increase their market share with retail accounts. But such a move would have to generate a sufficiently large share of business from retailers to make up for the margin compression.

Carriers Should Not Ignore Other Ways to Add Value

For the foreseeable future, same-day delivery will likely remain a niche offering. Carriers may want to focus more attention on low-cost and convenient delivery services, such as easy return processing and tracking, that customers appear to favor over same-day delivery. One of the most effective ways for carriers to avoid being viewed as a commodity provider is through investments in value-added services, such as parcel lockers, multiple delivery windows, and real-time delivery alerts. Exhibit 5 shows how important these various services are to consumers.

Regardless of how the delivery market develops, carriers should be embedding themselves in the flow of e-commerce by partnering with larger retailers, actively supporting purchase returns, and improving delivery tracking. If and when same-

Exhibit 5 | Consumers Care Most About the Basics



Sources: BCG survey of 1,500 consumers in late 2012; BCG analysis.
Note: Results include survey respondents' top three answers.

day delivery becomes more of a mass phenomenon, carriers will have the market knowledge, capabilities, and customer confidence needed to make it fly.

Same-day delivery may or may not have staying power. Given the current outlook, it would be unwise to either ignore or fully embrace the trend. The impulse of both retailers and carriers is correct. They should be actively trying to improve the customer experience and their own competitive position. But it is way too soon to tell whether same-day delivery is the right vehicle to achieve those goals. Tests and pilots make much more sense than big bets.

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