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Business Solutions

**Outsourcing Fulfillment  
for Wineries:  
Making an Informed Decision**

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## Outsourcing Fulfillment for Wineries: Making an Informed Decision

### Introduction

Faced with rising material costs and downward price pressure in the market, businesses naturally look to streamline operations to the greatest extent possible, and to extract every last bit of value from their existing resources. For wineries, one manifestation of this effort is the tendency to keep as many aspects of the business in-house as they can, avoiding fees to third-party providers. This is a laudable and occasionally successful strategy, but does it work for fulfillment? There are many complexities and hidden costs in fulfillment, some of which may be unknown to wineries at the time they consider whether to outsource their fulfillment operation. Cost burdens such as direct labor, packing materials, inventory management, and various operating expenses are all associated with keeping work in house. Time-consuming administrative, scheduling, logistics, and other support activities can drain precious resources as well, though may add little or no value. This short white paper considers some of these costs, and aims to help provide wineries with the critical information they need to make this important decision.<sup>1</sup>

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### The Basic Issues

As a general rule, outsourcing should be considered for an activity that supports, but is not central to, your core competency. For example, a winery focused on increasing tasting room sales and winery visits would probably consider marketing and seasonal promotions core competencies. However, the email communications, creation of data bases for maintaining customer lists, and shipping functions key to this focus are likely to be a non-core competency.



<sup>1</sup> To create the most accurate analysis possible, this paper uses the California Wine Institute's discounted courier rates in calculating projected costs for wineries doing their own fulfillment. We consider an average shipment volume of 3,100 packages annually divided among three couriers: UPS, FedEx, and Golden State Overnight (GSO). FedEx and UPS shipments are calculated at zone 6 rates, and GSO shipments are zone 4. We base the package size on actual averages as well, with roughly 30% being 2-bottle shipments, and smaller percentages for 3, 4, 6, and 12-bottle packages.

While many companies have embraced a “single focus” philosophy for managing their businesses and outsource as many non-core functions as possible, many continue to pursue multiple areas of focus, which can lead to missed opportunities or strategic missteps. Outsourcing should be part of a proactive strategy focused on ending the distraction of subsidizing a non-core competency, and freeing up resources to invest in a core competency. Companies often consider outsourcing only when demand finally overwhelms capacity, or when efforts to cut cycle times or operating expenses fail, or when chronic quality problems resist attempted fixes, by which time irreparable damage may have been done to the business. When outsourcing is merely a stopgap, rather than a focused strategy, an organization won't fully reap the benefits of outsourcing.<sup>2</sup>

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**The Real Cost of Wine Industry Fulfillment**

**Courier Costs**

The first cost area considered is often the courier rates themselves; that is, the cost paid directly to the courier, excluding all packaging, labor, etc. Fulfillment houses will of course benefit from significantly higher rate discounts than any individual winery can qualify for, though there are other cost areas to consider as well.

In addition to the basic zone based delivery charge, the courier fee can contain several additional charges, which can include charges such as these:

• Additional handling	\$8.75	• Remote area surcharge (AK)	\$17.50
• Delivery area surcharge	\$3.60	• Residential surcharge	\$3.35
• Address correction	\$12.35	• Undeliverable shipment	\$10.00
• Delivery outside service area	\$10.00	• Warehouse storage	\$13.00
• Dry ice	\$5.00	per package / day	
• Invalid acct / refusal fee	\$12.35	• Adult signature fee	\$4.65
• Package tracking, tracing	\$3.00		

On a single courier delivery charge, these additional charges could easily double or even triple the amount due, far exceeding the actual shipping fee.

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<sup>2</sup> “When outsourcing makes sense,” Machine Design, July 13, 2006, Lawrence Kren

Fulfillment companies are often able to have these fees significantly reduced or even eliminated depending on their volume, though individual wineries rarely merit such consideration from the couriers. In addition, because many fulfillment house systems are integrated with address verification systems, the possibility of an address verification charge is dramatically reduced. For an individual winery, an address that requires correction can cost \$9 from the courier, but even if it is caught by the winery before that, the cost can easily exceed \$9. After an employee discovers the error, he or she must fix the address in all of the systems which contain the address information at the winery (club, ecommerce, tasting room / POS, and accounting), which can be time consuming and error prone. If the label has already been printed, then it must be voided and reprinted, adding more time and cost. Keep in mind that a \$45,000 a year employee costs a winery an average of \$25.65 an hour after taxes.

Reducing additional courier charges and minimizing other costs such as address verification are central to the value created by fulfillment warehouses.

**Zone skipping:** Another important way that fulfillment houses can help reduce courier fees is to enable “zone skipping.” If a winery has 100 packages for New York, for example, rather than consigning them all to the courier in California and paying the zone 8 delivery charge, some fulfillment companies are able to palletize the entire lot of packages, ship them across the country in a temperature controlled freight carrier, and



then have them consigned to the local UPS or FedEx courier in New York. This changes the courier rate from zone 8 to zone 2 - 4, and can provide significant savings per package, even with the additional cross country freight charge. This sort of cost savings measure depends critically on very high volumes, however; single companies shipping their own packages generally cannot achieve these economies of scale.

Shipping in this manner is also a better and safer way to ship precious wine. Couriers' own zone-skipping transport vehicles are usually not temperature controlled and often have product stored at midway points in transit, increasing chances of damage, breakage or loss, and of course further subjecting product to non-temperature controlled environments as it moves in and out of the transit hubs. When the warehouses are consolidating weekly zone skipping shipments, door-to-door delivery time is close to that of a direct shipment, and sometimes is even faster.

**Materials:** Aside from labor, one of the biggest fulfillment costs is packaging materials such as the outer cardboard shell, the filler material (Styrofoam, “egg carton,” etc.), toner, tape, labels, etc. The average packaging cost in our analysis is \$2.75 per package.



With volume discounts, fulfillment companies are typically able to drive 40% - 50% discounts on these basic costs. The threshold for generating these discounts is several thousand shippers per month, however, again putting any significant discount beyond the reach of most individual wineries.

**Labor:** The area where the winery fulfilling its own packages will often bear the highest costs is labor. We assumed several efficiencies in our analysis and calculated an average labor cost of \$1.38 per package shipped. This includes all necessary functions for managing training, order processing, package building, fulfillment line, inserts, special packaging (gift wrap, gift messages), reporting and tracking, insurance and liability, etc. It also includes a small amount for direct ship compliance, though a winery's actual labor cost for compliance is likely to be higher.

More important than the high cost of labor are the various tasks and skills required for properly managing a fulfillment operation.

More important than the high cost of labor, however, are the various tasks and skills required for properly managing a fulfillment operation. Even if a winery has sufficient volume to make fulfillment of its own packages approach cost effectiveness, questions about required fulfillment skills and training for new employees should be considered carefully. In other words, is fulfillment a function that truly makes sense to invest in developing? The following, for example, must be addressed in some way when fulfilling packages:



- *Courier system interface:* Unless a winery ships every package with the same courier, it will need to log in to each specific courier website to generate labels for shipment. Most couriers will need to install special servers and printers at the fulfillment location, and these will not be compatible with each other. Whereas a fulfillment warehouse can generate an entire batch of labels for multiple couriers with one click of a mouse, a winery shipping its own packages will need to log in to each courier site and generate each courier-specific portion separately. One drawback of this approach of course is that it makes it impossible for the order, shipping and tracking data to reside in a single system, and to customize and make uniform the email confirmation messages for customers.
- *Email confirmations:* A winery shipping its own packages will either need to upload the recipient email into the courier system and have the courier system generate an automated (non-customizable) confirmation email, or will need to send confirmations to customers from a separate system. The latter approach is complicated by the need to include individual tracking numbers for each package in every confirmation notice.
- *Returns management:* In a typical batch shipment, there are inevitably returned packages; these can sometimes be as high as 5% of a total shipment. These

must be managed quickly and efficiently, and all customers must be contacted. Some orders will need to be reversed in the ecommerce and/or POS systems as well.

- *Misshipment liability:* When you ship a package incorrectly, you of course need to bear all the costs of correcting the mistake, including contacting the customer, issuance of a call tag, reversing the transaction in your systems, entering the correct address for the customer in all systems, reshipment expense, and possibly writing off the inventory if the misshipped package is not returnable (such as in a 3-tier state). Outsourced fulfillment companies generally cover the various costs associated with misshipment, assuming the data they received for the order was accurate and the misshipment was the result of a fulfillment error.
- *Employee allocation:* Fulfillment is a complicated and error prone process requiring a disciplined, systematic approach. Attracting and retaining a warehouse fulfillment manager with the requisite skills to manage the logistics, IT, and communication for fulfillment will likely cost a winery between \$85,000 and \$110,000 a year. If the fulfillment team is comprised of staff whose primary responsibility lies elsewhere, fulfillment costs will rise across the board, and true efficiencies will continue to elude the winery.
- *Documentation:* Many states have shipping documentation requirements which require further time and precision, and your own marketing campaigns may demand special inserts and packaging. Many fulfillment warehouses have systems which can customize packages by state, order type, and even your own marketing campaigns (sending special emails and different customer service numbers in the tracking confirmation emails for your club members, for example, as opposed to those sent to online customers).

Managing returns and mis-shipments is another major part of fulfillment, the costs for which are often overlooked by wineries.

**Storage:** Storage for shipping materials is an often-overlooked cost of fulfillment. Because wine shipping materials are bulky (especially Styrofoam), storing even a relatively small amount of packaging can take up an entire room. Storing sufficient quantities for larger club or release shipments can require more than 1,000 square feet. Storage areas need to be dry and cool, and free from dust or excessive dirt.



**Equipment & Overhead:** In addition to regular packaging, the equipment used in a fulfillment operation such as tape guns, toner and printers must be replenished constantly to ensure sufficient supply. Depending on the size of the fulfillment

operation, a separate computer or computers will be required, and possibly a separate server (for each courier) if frequent calls will be made to courier servers and label data will be transferred. Mechanical breakdowns of the equipment and printers are inevitable as well, and may require several hours of time from your staff to fully address. General overhead expenses such as insurance and employee taxes should not be overlooked either.

Managing a fulfillment operation also means addressing mechanical breakdowns, bulk purchasing and storage of shipping materials, and other overhead costs not typically borne by wineries.

**Overall Efficiencies**

As the table below suggests, our analysis shows that for a winery shipping just over 250 packages a month, the cost for outsourcing fulfillment is *lower* on average than the cost for keeping fulfillment in house. **Outsourcing saves an average of \$0.36 per package, based on a weighted average of package sizes.**

<u>Pack Size</u>	<u>Winery</u>	<u>Outsourced</u>	<u>Savings</u>	<u>Savings/Pk</u>
2-bottle	\$20.85	\$20.35	\$487.20	\$0.50
3-bottle	\$21.44	\$20.71	\$254.50	\$0.73
4-bottle	\$24.67	\$24.38	\$247.00	\$0.29
6-bottle	\$28.11	\$27.91	\$75.50	\$0.20
12-bottle	\$41.89	\$41.45	\$111.00	\$0.44
Other	\$38.89	\$39.05	-\$49.00	-\$0.16
<b>TOTAL</b>	<b>\$175.85</b>	<b>\$173.85</b>	<b>\$1,126.20</b>	<b>\$0.36</b>

Numbers may of course vary slightly based on a winery’s own shipping efficiencies, and on the percentage of 2-bottle, 6-bottle, or full case orders a winery ships. The important point here is not so much the cash savings itself (though it represents an extra \$360 in net profit for every 1,000 shipments), but the dramatic increase in efficiency and overall productivity a winery can achieve by outsourcing fulfillment. If the cost of outsourcing fulfillment were 20% higher than managing it in house, the argument for outsourcing it—and thus freeing up resources to focus on building up the core winery business—would be strong. When the cost of outsourcing it is equal to or *even less than* performing this function in house, the question of whether to outsource truly answers itself.

**Conclusions**

The #1 reason to outsource fulfillment is to allow you to focus more on what you do

best—making and selling wine—so that you can grow your business faster. Put simply, a winery could hire a manager and a whole warehouse of people to run its fulfillment operation, or it could outsource fulfillment to a company that provides all these people already seasoned with many years of hard-won fulfillment experience.

When a winery outsources fulfillment, it gets a warehouse, order-processing equipment, computer and software systems, and all the things necessary to run an order-processing operation. Outsourcing provides all the benefits of a full-service backroom without the fixed overhead costs; wineries pay for fulfillment only when sales are generated.

The attempt to maintain expertise across a wide range of technology and functionality is ambitious, and extremely risky. First, it drains funds that would be better invested in a core competency. Second, funds transferred from core to non-core competencies are generally insufficient to let your company compete with organizations that specialize in the latter.<sup>3</sup>

In sum, outsourcing fulfillment can be an effective strategic decision for wineries focused on growth for several reasons. These include:

✓ ***A Third-party Fulfillment House has Deeper & Broader Experience***

A seasoned fulfillment house will have already developed and refined order processing, packaging, shipping, and data-handling operations for a wide variety of products. Consequently, it is better equipped to handle the inevitable problems and opportunities that will come as your business expands. Furthermore, an active, broad-based fulfillment company is always up-to-date with the latest software and order-processing technology, so that that it can keep its clients on the leading edge, starting with its first orders.

✓ ***Outsourcing Preserves Capital***

You do not have to make investments in buildings and facilities, and you only pay for what you use. When creating a backroom on your own, you must ask, “How much space do I need? Should I buy or rent? When you outsource your fulfillment, you need not worry about any of these issues. And as shown above, you will likely be saving money on the actual fulfillment cost for every package as well.

✓ ***Outsourcing Can Enhance Your Customer Service***

When a winery outsources fulfillment, it gets a warehouse, order-processing equipment, computer and software systems, and all the things necessary to run an order-processing operation.

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<sup>3</sup> Fulfillment Outsourcing 2007: How & Why? Coast to Coast Fulfillment Inc., 2007



Once the product gets out the door, the fulfillment process is hardly finished. Some shipments will be undeliverable, and some customers will want to return products for replacement, refunds, or service. Is your fulfillment operation set up to handle this efficiently? Remember of course that couriers will charge a significant amount for each return.

### ✓ *Outsourcing Fulfillment Makes Your Business More Efficient*

A third-party fulfillment company should have the latest software, order-processing equipment, continual operational maintenance and software upgrades, and volume discounts on shipping and materials that only a larger order-processing facility can afford. You benefit from these efficiencies while not having to pay directly for them. Outsourcing can give you highly qualified people and the latest technology, to deliver order-processing services at far below most companies' "in-house" costs of doing the same operations. Since backroom operations are the focus of a good fulfillment company, it should excel at them. A busy fulfillment house is accustomed to operating at peak efficiency to reduce costs, while keeping its clients on the leading edge of quality order processing and customer service. Plus, they know how to resolve problems with couriers, making sure that couriers retain liability for the package once it leaves the warehouse.

### ✓ *Outsourcing Saves Time*

Software development takes less time when people are working on your applications around the clock, so you can get your product shipped quickly and efficiently, with minimal turnaround time. And when you outsource, you don't have to spend time recruiting, hiring, training, and managing employees for fulfillment and inventory management projects.

### ✓ *Outsourcing Allows for Scalability and Seamless Growth*

Growth means your order volume will increase. The question is how fast this will happen and whether it will prevent you from filling orders within an acceptable amount of time. Even if your business has temporarily leveled off and you are now focused on spending more time developing new secondary business opportunities, such as affiliate relationships or other marketing and business development opportunities, outsourcing all or part of your fulfillment might free you to be able to pursue these opportunities.<sup>4</sup>

### ✓ *Outsourcing Provides Instant Status Reporting*

A good fulfillment system will report on the status of any order to any department that needs the information. One benefit for many small businesses of performing fulfillment in-house is the proximity of data and inventory. But just because you have all the pieces of information available doesn't mean you will be able to make use of them.

If the cost of outsourcing fulfillment were 20% higher than managing it in house, the argument for outsourcing it—and thus freeing up resources to focus on building up the core winery business—would be strong. When the cost of outsourcing it is equal to or even less than performing this function in house, the question of whether to outsource truly answers itself.

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<sup>4</sup> "Should You Outsource Order Fulfillment?" Delilah Obie, 2008

## Are you prepared to manage all fulfillment challenges in-house?

A professional fulfillment house with its fully integrated order fulfillment system will be able to generate reports and verify order status easily. Your volume will determine how much emphasis you need to place on this issue.

Will you be able to monitor your inventory sufficiently to know how many orders for a particular item you can fill? Likewise, a fulfillment system should ideally be able to halt a sale if the item is not available. With an insufficient system, orders may go unfilled for unreasonable lengths of time, frustrating your customers. Professional fulfillment houses are trained and prepared to avoid such situations. Are you?

Regardless of whether a winery decides to outsource fulfillment, a winery needs to use its resources wisely, and address its customers' needs completely. In the end, it is critical to remember that getting the product to the customer is just as important as making the sale.

Contact us today for more information: [info@fortsystems.com](mailto:info@fortsystems.com)



The following chart lists a few costs and benefits of outsourced fulfillment vs in-house fulfillment, and illustrates that while both must address similar costs, virtually none of the benefits or economies of scale are available to the in-house fulfiller.

<b>Outsourcing: A Quick Checklist</b>	<b>3rd Party Warehouse</b>	<b>In-House Fulfillment</b>
<b>COSTS</b>		
High labor cost	✓	✓
Investment in buildings and facilities required	✓	✓
Storage space required	✓	✓
Pay insurance premiums for laborers	✓	✓
Management time required for training fulfillers	✓	✓
Fulfillment equipment maintenance and costs	✓	✓
Daily manifest / BOL required from couriers	✓	✓
<b>VOLUME BENEFITS</b>		
Maximum courier discounts	✓	✗
LTL freight to closer courier hub option (zone skip)	✓	✗
Maximum commercial discounts for materials	✓	✗
<b>CAPABILITIES</b>		
Manage all couriers from one interface	✓	✗
Instant Status Reporting Available	✓	✗
Customize email confirmations	✓	✗
Misshipment liability covered	✓	✗
Customize packages by state, product, or campaign	✓	✗
Returns management	✓	✗
Zone skip routing	✓	✗
Integrated 3-tier routing option	✓	✗
Various state document requirements managed	✓	✗
All employees focused on company's core business	✓	✗
Fulfillment solution scalable	✓	✗