

A Model to Determine an Optimal Shipping Fee Policy

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Finding the optimal shipping fee policy involves the determination of the shipping fee and the free shipping condition, i.e., the cutoff levels above which customers no longer have to pay a shipping fee. The shipping fee policy strongly influences customer behavior and consequently profit of the retailer. This paper (i) presents an overview of shipping fee policies across five industries and two countries that shows that retailers have substantial flexibility in setting their shipping fee policy, (ii) develops a model to determine the optimal shipping fee policy of an online retailer, (iii) proposes an innovative method to calibrate all parameters and (iv) applies the model in a field experiment. The results of the application show that our model mirrors customer behavior very well and enables the online retailer to increase gross profit by 9%. Surprisingly, contingent free shipping, that is the common practice to offer free shipping above a certain cutoff level, was not the most profitable solution.