Drop shipping

Academic head:

Fabrice PIRNAY

Antoine BAGUETTE

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II. Executive summary

In 2017, e-commerce grew by 17 %. Even today, e-commerce is doing extremely well and is growing at a fast pace. More and more companies are developing their online presence and total sales reached nearly \$ 2 billion in 2017. Observers say this growth is not about to stop and therefore, e-commerce has a bright future!

The rise of marketplaces such as AliExpress or Amazon gives access to tens of thousands of online references at very competitive prices. Following this, an opportunity for digital entrepreneurs was born: **drop shipping**.

Drop shipping is a kind of e-commerce by which the seller has no product in stock and deliver the final customer directly through his supplier (without the customer knowing it). So, the merchant does not have in stock, the product he sells. He buys it from his supplier when the customer effectively places an order. It is then the supplier who takes care of the delivery to the final customer. The goods never go through the seller's stock.

Drop shipping has many advantages for entrepreneurs wanting to engage in e-commerce: starting capital reduction, overhead costs reduction, negative need for working capital, ease of implementation, geographical freedom, choice of a wide range of products, easy expandability and invisibility of the supplier.

However, this way of e-commerce also has some disadvantages such as low margins, inventory problems, complex delivery and potential vendor errors.

All products do not lend themselves to this practice and one must select the right suppliers while paying attention to scams. Nevertheless, with an adequate strategy, an entrepreneur can then select products that meet different criteria (niche, potential margin, and so on) and face the risks/pitfalls of this practice. He can then focus on promoting his shop to sell a maximum of products in order to generate revenue for his business. This will be possible provided only if one respect the key factors of success.







III. Context

This note is a practical guide for (young) Belgian entrepreneurs willing to develop an ecommerce store. We will see how to create a low-cost and professional e-commerce platform. This document is not a commercial guide extolling the merits of drop shipping. It is, on the contrary, a review of what you need to know to build your own online store avoiding pitfalls.

After laying the theoretical foundations, this guide covers practical elements such as the choice of products, the choice of suppliers, the mistakes to be avoided, the key success factors, the legal form, and so on. This note is based on my research and expert interviews.

IV. Drop shipping

Bathelot (July 19, 2015) defines drop shipping as "a form of e-commerce by which the seller site has no stock and deliver the final customer directly from his supplier without the customer knowing it. [...] ". The merchant does not have in stock, the product he sells. So, he buys it from his supplier when the customer effectively places an order. As shown in the illustration below, the supplier is responsible for delivering. The goods never go through the seller's stock. Drop shipping therefore solves fundamental questions related to the size of companies such as (Blavier, interview, February 19, 2018):

- 😻 What do I do with my stocks?
- We how am I able to manage supply and demand as the size of my company, my logistics, my positioning, my location, and so on makes it impossible?



Illustration 1: drop shipping way of working

The job of the merchant consists of identifying a product and arise the interest of prospects (marketing) towards it by diffusing targeted advertisements which lead them on an e-commerce shop where they can buy it. The seller's work can be schematized as in the following figure.



V. Advantages

1. Decrease in starting capital and costs reduction

As stock is not required, investments (warehouses) and fees (order management, logistics, and so on) are drastically reduced. At the beginning, an amount of €1,000 is enough to cover hosting costs, company creation, and so on.

2. Negative need in working capital

As the customer pays for the product before the seller orders it, the working capital requirement is always negative. This is a significant advantage knowing that poor cash management is the third cause of bankruptcy in Belgium (Bricmont, April 23, 2017).

3. Easy to set up

Unlike a traditional e-commerce site, drop shipping does not care about warehouse management, order packaging, and so on. A drop shipping platform is therefore easier to set up than a traditional platform.

4. Geographical freedom

Drop shipping does not involve warehouse and inventory management, it is possible to manage your platform from anywhere, provided you have access to Internet and a computer.

5. Wide **range** of products

It is possible to sell everything as there is a multitude of suppliers who accept drop shipping. Moreover, as the stock is no longer essential, the seller can then offer a range of product as extensive as desired.

6. Easily expandable

With a traditional e-commerce website, if affluence doubles, work will also double because it will be necessary to store more merchandise, to pack more orders and to ship more products. With drop shipping, this increase of work will happen at the supplier!

7. Supplier **invisibility**

Despite his crucial role, the supplier is invisible to the end customer because it is the address of the vendor and his logo that appear on the package.





VI. Disadvantages

1. Low margins

As drop shipping reduces barriers to creating an online store, competition is bigger and stronger. Margins are (much) lower and the customer acquisition cost is higher (O. Mallue, Email, November 7, 2017). Some sellers voluntarily lower their prices (we will see that this is not a good strategy) hoping to achieve a significant sales volume. In order to minimize competition, it is therefore essential to choose a niche sector to sell your products.

2. Inventory issues

As stock is not managed by vendors and suppliers has multiple customers, the inventory level is constantly changing. Although tools, such as Oberlo¹, to synchronize the inventory levels of the seller and the supplier exist, it doesn't prevent some products to be out of stock.

3. **Delivery** complexity

When a customer buys several products on the same site, these may come from several suppliers. The customer will then receive several packages and this will decrease the customer experience. Delivery costs are also more difficult to calculate.

4. Suppliers mistakes

Even the best suppliers make mistakes: too long delivery times, lost packages, damaged/broken products, bad packaging, and so on. As a result, customers will not be happy and are likely to complain. As customers are unaware of the presence of the external supplier, the seller will have to take responsibility for the supplier's errors in front of customers.

5. Products

Drop shipping is not suitable for all products. It is unlikely that drop shipping vendors will offer very qualitative products (vegan food, and so on). Indeed, drop shipping is better for generic products whose consumers do not worry about origin, traceability, and so on (Blavier, interview, February 19, 2018).









¹ https://www.oberlo.com

VII. Products selection

Products choice is vital with drop shipping. Below, we will see a method to identify products with high potential (Youderian & Hayes, n.d.).

1. Select a niche market

- V Passionate people: they are easier to convince and they buy compulsively.
- V Businesses: although price is more sensitive, they buy for larger amounts.
- Vertice where purchases are recurring: the seller is exposed to regular purchases.

Searching for a niche is a simple process, just choose one of your passions or conduct an Internet search (Trendhunter.com allows to have product ideas).

2. Statistics

It is important to consult statistics to find a product with a high (or growing) volume. Leo Guillot (YouTube: studying sales volumes) suggests:

- V Amazon: the number of comments on a product is an important factor.
- 🔰 Google Trends: analyses of search volume and estimates product popularity.

3. A low price with a high potential margin

In general, it is interesting to select products between \$1 and \$20. This then allows to set a selling price between \$20 and \$50 (or more) (Ferreira, n.d.). A good e-commerce shop realizes between 25% and 60% of net margin². Selling a product as cheaply as possible is not a sustainable strategy. On the contrary, in order to differentiate (and set a higher price) one have to value other elements (we will come back to this later).

4. Size and origin

The ideal is to sell products of small sizes to limit expeditions expenses. In addition, selling products that are not found locally increases the chances of success.

5. Find a product that can be grafted to other **components**

The more add-ons are added to a product, the more value it has for the customer. Identifying different accessories that go with the product can thus improve the margin.





² https://devenir-entrepreneur.000webhostapp.com/40%20idee%20de%20niche%20rentable.pdf

6. Changes

One will avoid choosing products that change too often in order to reduce the workload (not to change the website constantly).

7. Avoid trademarks

Avoiding brands to protect against fakes is a wise idea. We must look for products that are not labelled with the colours of a brand, even if it seems true.

8. More than **300 orders**

A product that has received a lot of orders makes it possible to know that there is a demand for the product and can also suggest that the supplier is reliable.

9. At least 4.5/5 review

This ensures that the product is evaluated and that the seller also receives positive feedbacks. The Chrome plugin "AliExpress Seller Check" gives a second opinion.

10. Many pictures

This allows to illustrate a website. It is however advisable to carry out a quick Google search to see if the pictures used by the supplier really belong to him.

11. A seller who communicates

Do not be afraid to ask questions to suppliers before ordering. A serious supplier will answer quickly. If he does not answer, be careful!

VIII. Platform selection

Lot of people recommend AliExpress. It is a giant virtual marketplace with all the products you can imagine. Moreover, as suppliers available on AliExpress are global producers, prices are very competitive. We can therefore directly buy products at wholesale prices and have them sent directly to customers.

It is also a very simple platform where search for products is easy. In addition, there is no cost of entry, so it is possible to test any product for free. Finally, many suppliers on AliExpress have beautiful pictures and product descriptions that can be used on our own site (Ferreira, n.d.).





IX. Supplier(s) selection

1. Find a supplier

- Contact directly the supplier of your choice. In the event that the seller knows the product(s) he wants to sell, he can contact the manufacturer directly to request a list of wholesalers. It is then possible to contact the wholesaler to see if he accepts drop shipping.
- Use **Google**. Manufacturers are often very bad at marketing. Consequently, their search engine ranking and their website are often very inefficient. Therefore, it will take a long time to find a provider using Google.
- Ordering on a competitor's site. It is possible to know the supplier of a competitor by buying an item of the competition. It will then be necessary to research the return address of the parcel. It's a simple way to see which suppliers are used by competitors.
- Go to **trade shows**. Fairs are places where a salesman can meet different people who might become suppliers.
- Consult a register of suppliers. A supplier's register is a database with different vendors in certain areas. Examples: Worldwide Brands, SaleHoo, Doba, Wholesale Central.

2. Identify fraudulent suppliers

It is necessary to be cautious when looking for suppliers because many of them are fraudulent. There are two things to consider when choosing a supplier: fraudsters try to charge fees constantly and they sell directly to end customers.

3. Before contacting suppliers

Some providers will ask for proof of the legality of the seller's business before doing business with him. Therefore, it is necessary to create a legal structure (we will discuss the legal structure in another section of this note) before contacting these suppliers, otherwise they will be very reluctant to disclose a prices list.







X. Risks and how to avoid them

1. Suppliers mistakes

Even the best suppliers make mistakes and you have to know how to handle them correctly. The solution to this problem comes in three steps (Youderian & Hayes, n.d.):

- As the customer is not aware of the existence of the supplier, one must, in front of the customer, take the responsibility of mistakes, apologize and explain how he will manage it. This helps not acting as an amateur and avoids unnecessary confusion.
- Taking responsibility for the mistake facing the customer does not mean that you have to pay for this mistake! The supplier must therefore pay for his mistake.
- Make up by offering something (for example: shipping costs, a new product, a product complement, and so on) to the customer to compensate for the mistake.

2. Security

On one hand, storage of bank data is very convenient when a customer comes back to the site. On the other hand, it requires many safety precautions. In addition, the new European Data Protection Legislation (GDPR) is very restrictive (it comes into place on May 25, 2018). At the beginning, the best solution is not to store the visitor's bank data to avoid any problem in case of piracy. In case of problems, the seller can be responsible.

3. Fraud

One must have a verification system that verifies that the billing address is the same as the delivery address. Indeed, in case of fraud, thieves always send the package to a different address from the billing address. Therefore, special attention must be paid to these transactions. Moreover, in case of proven fraud, it is the seller who will have to repay the injured customer!

4. Counterfeiting

In case of sale of counterfeit goods, the seller is responsible. Whether or not he knows about the fraudulent origin of the products. The seller is therefore liable to have his product intercepted at customs, to pay fines and to reimburse the consumer (Ernotte, interview, February 2, 2018).









5. Defective products, hidden defects and standards

Although the seller is not responsible for the defectiveness of a product, it is always advisable for the seller to reimburse the customer. In Belgium, there is a special regime that protects the consumer against defective products (Ernotte, interview, February 2, 2018). This scheme is the *legal warranty* which defines that within six months after the sale, the seller has the obligation to replace a defective product. After this period of six months, it is up to the consumer to prove that the product was defective. If this is the case, the seller will have to refund the product. This is also the case for hidden defects.

For products with low values, it is not advantageous to ask the customer to return the defective product. Therefore, it is good practice to send directly a new product.

With regard to standards (example: CE), the seller must check that the products he sells is complying with the safety legislation in force. In case of doubt, the responsibility of the seller will be questioned and the products will be blocked at customs.

6. Return policy

It is essential to have an extremely well-defined return policy to avoid problems. This involves the redaction of very specific sales conditions that mark out the buyer/seller relationship, the complaints, the way to question the product, and so on (Ernotte, interview, February 2, 2018)! However, it is important to pay attention to the restocking fees that some suppliers are charging. Here is an example of a return process (Youderian & Hayes, n.d.):

- V The customer contacts the seller to request a return.
- The seller requests an RMA (Return Merchandise Authorization) code from his supplier.
- V The customer returns the package to the provider by specifying the RMA code.
- Vertical The supplier refunds the vendor.
- V The seller refunds the customer for the total amount.

However, many suppliers do not offer the option of returning products. It is then up to the seller to take care of it himself. Therefore, it is often easier to pay the customer directly or to send another product.

/!\ Note: in Belgium, the consumer has the right to withdraw within 14 days of purchase. The consumer must then return the product and the seller refund it (Ernotte, interview, February 2, 2018).



XI. Key success factors

1. Investment

There are two approaches to creating a drop shipping shop: create your own shop or outsource the process. Although the first solution could block people, it's the most effective! Indeed, it is important to master and understand how it works. However, it is not always necessary to realize all by yourself (Youderian & Hayes, n.d.).

2. Calculation of shipping costs

Calculating delivery fees is often complicated because for the same shop, there are often several suppliers. To calculate precisely the expenses is thus rather complicated but there are three ways of calculation:

- The real-time calculation method that adds the weights of the different products purchased and calculates the total amount of the shipping cost. It is a precise but complicated method because products can come from different warehouses.
- W The calculation by type of products: in this method, shipping costs are calculated by product types (example: small product €5, large product €15).
- The universal calculation: identical pricing for each type of products. We can even consider offering shipping costs. This method is the simplest but the least accurate. This last mode of calculation is perfect to begin its activities (simplicity). It can be subsequently adapted.

3. Specialization

The competition is so high that it is essential to specialize in a niche market. You have to position yourself as an expert in order to benefit from the trust of prospects. Moreover, the specialization also allows to set a higher price because the seller is seen as a legitimate specialist.

4. Value creation

Creating value for customers is certainly the most important success factor. This value can come from various factors such as information, quality of service, customer experience, support, advice, and so on. In addition, service has become an essential element since the arrival of social media. Indeed, customers talk about their experience on this type of platforms.







5. Long-term perspective - invest time

Success does not come overnight. It is necessary to invest time and to have long-term goals. Do not give up and invest time is the first factor to success. The ideal is to spend as much time as possible working on your shop to maximize your chances of success. The first months are certainly the hardest because they are full of doubts, but it's normal, you have to believe in it and not give up! Experience shows that this system takes around 12 months (working full time) to reach an average annual income of \$50,000 (Youderian & Hayes, n.d., p. 39). On the other hand, once the shop has reached such a size, a much smaller effort is needed to keep it up to date.

6. Other important factors

- Competitive watch: it is very important to keep an eye on the competition. To find out what they are doing, the prices they have, their strategy, and so on.
- V Technology watch: it is very important to keep an eye on technologies.
- Critical thinking and questioning: once a system works, you have to try to see how you can improve it or destroy it yourself rather than competitors.
- V Taking the buying context into account and knowing how to manage data.
- V Products and suppliers check to protect against fraud, defective products, counterfeit products, and so on.
- 🔱 A good marketing policy requires effective targeting. Facebook advertising is a tool that allows such targeting. It is therefore essential to understand it.
- 🔰 It is essential to optimize your site to improve SEO and carry out paid search campaigns (SEA). This optimization involves writing rich and relevant content (product description for example) (Blavier, interview, February 19, 2018). In addition, Blavier insists on the need of storytelling. This is even more interesting if you do it in video.







XII. Questioning

1. How to organize legally a structure?

All serious entrepreneurs go through the creation of a legal entity to oversee their business activities. In Belgium, drop shipping activities can be conducted in the following manner (Ernotte, interview, February 2, 2018):

🔰 As private individual

- o Part time self-employed (complementary way).
- Full time self-employed.

😺 As company

- Private limited company.
- o Limited company.

In my personal case (student), Ernotte (interview, February 2, 2018) recommends the creation of an activity as private individual because of the low cost of creation. Nevertheless, he insists on moving quickly to an SPRL (private limited company) when the business grows, and this, to optimize taxation and further protect my personal wealth. Indeed, a common mistake when starting a start-up is to mix the personal capital and the one of the company. This creates confusion and makes accounting more difficult. Therefore, it is necessary to separate as much as possible personal funds from corporate funds. When a company is created, it will also be necessary to create:

- A checking account: this will make accounting easier. All cash inflows and outflows on behalf of the company must be made from this account.
- V A PayPal account: because it is a frequent means of payment for online purchases.
- V A credit card: to buy the merchandise and thus earn loyalty points.

2. Which obligations?

According to Ernotte (interview, February 2, 2018), it is necessary to distinguish different types of obligations:

- Use a social insuration of the second security contributions.
- Tax obligations: subject to VAT, prepare quarterly declarations, deposit a list of clients on a yearly basis, pay VAT, declare income. Attention to the regime of the franchise: if the turnover is lower than 25.000 € per year, the independent is freed from a certain quantity of obligations.
- V Administrative Obligations: Register at the Banque Carrefour des Entreprises (BCE).





3. Is drop shipping sustainable in the long run?

In the short and medium term, drop shipping is an ideal system and very interesting to start an activity since it requires very little initial investment. Nevertheless, in the long term, from the point of view of an entrepreneur, it is a little more complicated because:

- When a company grows up, it will be forced to take control of certain elements and the management of the stock is part of it. Drop shipping is therefore not the ideal model in the long term (A Blavier, interview, February 19, 2018).
- In the long term, there is, in a traditional shop, a potential risk of competition between the seller and his supplier (O. Mallue, Email, November 7, 2017).

4. What are the costs of importing goods in Belgium?

When clearing customs, it is necessary to pay:

- Import duties if the value of the package (even a gift) exceeds €150. Import duties are calculated on the "customs value" found on the postal customs document or on the invoice, plus any shipping costs.
- VAT if commercial packages are worth more than €22. VAT is calculated on customs value plus import duties, excise duties and other charges.
- Unties and taxes on shipments without commercial character from individual to individual (even a gift) and worth more than €45.

Note: In some cases, no duty or tax is due, it is called franchise. For more information related to customs fees and VAT

- https://www.bpost.be/site/fr/residential/parcels/international/Frais_suppl_paquets_internationaux.pdf
- https://www.bpost.be/sites/default/files/product/POSK0995_bpack_Documentsdedouane_FR.pdf

5. Why would someone buy on my site instead of doing it on AliExpress?

With a drop shipping platform, the competitive advantage is certainly not the price nor the unique property of the products! The competitive advantage lies in marketing: for example, a supplier like AliExpress has so many products to sell that it does not have the marketing budget to promote all its products in the same way.

The added value lies in the fact of touching the customer before a competitor does it and this involves adding value to the product (build a brand, create content, have quality customer service, and so on). (Ferreira C., n.d.).





6. How to handle long delivery times of Chinese suppliers?

The first thing to do is to be honest! It should be clearly stated on the website that delivery times are as many days. In this way the customers have a direct and easy access to this information. On the other hand, for the customers who would not have read this page and who will send an email to know where their package is located, it allows to justify you objectively.

A second step is to use a parcel tracking application (there are many on Shopify). So, when a customer contacts you, you can tell him exactly where his product is. This improves the customer experience.

Finally, a good strategy is to offer shipping costs as compensation for the long delivery time.

		Part time self employed	Full time self employed	PLC
Creation	0. Status publication	/	/	€ 222.76
	Starting capital	/	/	€ 1 - 18,550
	1. Checking account + credit card (Belfius)	€ 70/year	€ 70/year	€ 70/year
	2. BCE inscription	€ 87	€ 87	€ 87
	3. VAT identification (VAT regime)	€ 72.6 (franchise turnover<€25,000)	€ 72.6 (21%)	€ 72.6 (21%)
	4. Social contribution affiliation ³ (social contributions)	3.05% social contributions (€0 if net income <€1499,14 ⁴)	3.05% social cont. (depends of income)	€347.5 (depends of income)
	5. Mutuality affiliation ⁵	€138/year	€138/year	€138/year
	6. General conditions of sale (DKW Law)	€500	€500	€500
Exploitation	Website creation ⁶	€3,000	€3,000	€3,000
	Accountant ⁷	€600 - 800/year	€1,000–1,500 /year	€2,000–5,000/year
	Digital marketing ⁸	€3,650	€3,650	€3,650
	PayPal Account	/	/	/
	Hosting fees (OVH)	€72/year	€72/year	€72/year
	Shopify Basic	€300/year	€300/year	€300/year
	Other plugins	€500/year	€500/year	€500/year
TOTAL		+- €9,000	+- €10,000	+- €20,000

7. Drop shipping seems interesting but how much does it cost?

Table 1: drop shipping costs estimation

⁸ Hypothesis : €10/day









³ Acerta

⁴ Depends on income

⁵Mutualité chrétienne

⁶ https://www.lafabriquedunet.fr/creation-site-ecommerce/articles/cout-creation-site-ecommerce/

⁷ https://www.partena-professional.be/fr/blog/2017/combien-coute-un-comptable/

XIII. Example: "8 months and \$1 million de dollars later"

To illustrate this technical note, I will tell the story of Irwin Dominguez. This young Californian is an illustration of the drop shipping success because he became a millionaire in just a few months thanks to this sales technique. To tell this story, I will base myself on the article written by Andrew Roach in March 2017.



Illustration 3: Irwin Dominguez

How did he start?

He started after a friend told him about drop shipping. When he saw his results, he did not hesitate to embark on his turn. So, he opened a Shopify account, created his shop and added some products using the Oberlo app, that's all! He did not do a lot of research on the subject before starting, he wanted to learn by doing.

What was he doing before?

Before having a very profitable e-commerce store, Irwin was a marketing consultant for landscapers and plastic surgeons. His role was to use digital marketing to acquire new customers. Today, he admits it: he does not regret his previous job.

Does he remember his first sale?

Yes! It came only three days after launching his shop. Like a lot of traffic on his site, the customer came through Facebook ads









What is his motivation?

The inspiration comes from his wife. He would do things differently if she was not there. He has a very down-to-earth approach to success. He does not live for expensive cars or expensive homes, he just wants to be able to support his family.

What is his sales record?

The record: \$30,000 in one day! Current incomes are around \$10,000 a day and he hopes to one day beat his record again.

There are always ups and downs. For example, when you find a target audience that likes the product you're selling but you've already touched those people, you have to find another target or find a new product. For a business like drop shipping, finding the right product/audience takes time and is a big source of frustration.

If he was to start again today, what would he do differently?

He would set up a drop shipping process as soon as possible. Because the beauty of drop shipping is that you can sell anything to anyone in the world. So, if you find the right product and the right audience, you can generate a lot of sales quickly. That's what happened to him. However, everything was not yet in place. He did not cope with the influx of orders.

What are his tips for getting started with drop shipping?

Start as soon as possible because we have nothing to lose! The best time to start is now! His only regret is not to have started earlier. He is convinced that if he had launched his shop a year earlier, he would have made a lot more sales because the competition was much lower than today. However, he is convinced that there is still a lot of money to be made with this technique.

Moreover, he thinks that with the right state of mind and a little creativity, everything is possible! He does not understand why not more people embark on the adventure because with all the technologies that exist, it costs almost nothing to get started and it's not complicated!







XIV. Learn more

Custom, VAT, importation and shipping

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Legal aspects

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Experts contact information

- Lawyer: Florian ERNOTTE (04/222.17.12) - <u>f.ernotte@bls-avocats.be</u> – BLS Avocats
 E-commerce expert:
 - André BLAVIER (0478/22.66.61) <u>andre.blavier@gmail.com</u> Agence du Numérique
- Ex-manager of an e-commerce drug store [NewPharma]:
 Olivier Mallue (0472/938118) <u>o.mallue@gmail.com</u> Paperit
- Drop shipping expert:
 Léo Guillot (+41795518369) <u>l.guillot@glcagency.com</u> GLC Softwares & Marketing

<u>Other</u>

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