



Chapter 9

Online Retail and Services

Blue Nile Sparkles For Your Cleopatra

Class Discussion

- Why is selling (or buying) diamonds over the Internet so difficult?
- How has Blue Nile built its supply chain to keep costs low?
- How has Blue Nile reduced consumer anxiety over online diamond purchases?
- What are some vulnerabilities facing Blue Nile?
- Would you buy a \$5,000 engagement ring at Blue Nile?
- **Income Statement**

Major Trends in Online Retail, 2008-2009

- Social shopping
- Online retail increasingly profitable
- Buying online becomes normal, mainstream experience
- Selection of goods increases, including luxury and customized goods
- Average annual amount of purchases increases
- Specialty retail sites show most rapid growth
- Increased emphasis on improved shopping experience

Major Trends in Online Retail, 2008-2009 (cont'd)

- Increased use of interactive multimedia marketing
- Retail intermediaries strengthen in many areas
- Retailers increasingly efficient at integrating multiple channels
- Personalized goods, especially in apparel, become financially successful
- Online shopping becomes more multi-seasonal
- Most online shopping occurs at work, evenings at home

The Retail Sector

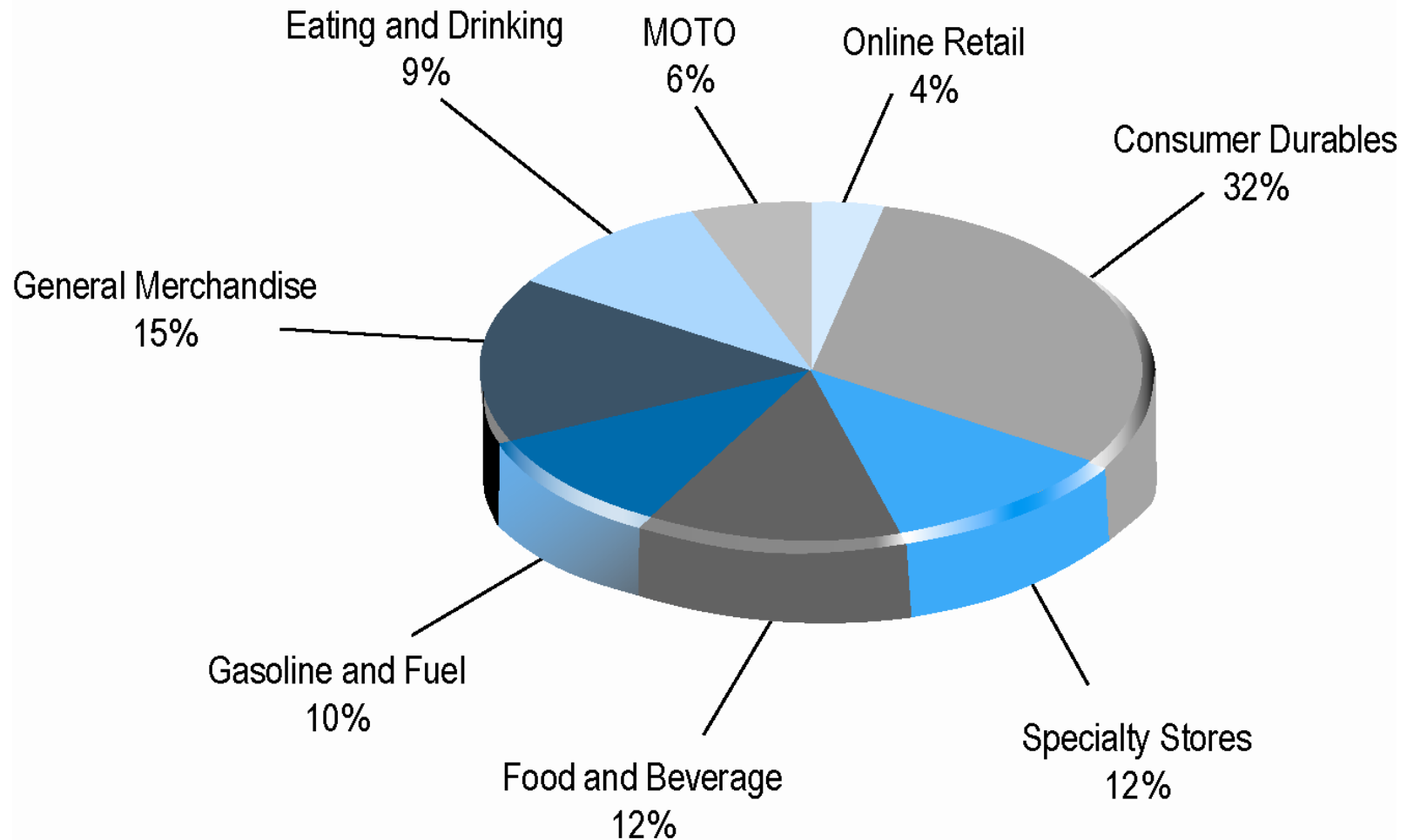
- Most important theme in online retailing is effort to integrate online and offline operations
- U.S. retail market accounts for over \$9.3 trillion (70% of total GDP)
- Personal consumption:
 - 59% services
 - 29% nondurable goods
 - 11.5% durable goods
- Distinction between “goods” and “services” becoming more ambiguous

The Retail Industry

- Retail industry divided into nine segments, each of which offers different opportunities for online retail
 - Informational opportunities
 - Direct purchasing opportunities
- Consumer durables largest segment, then general merchandise
- Mail order/telephone order (MOTO) sector most similar to online retail sector
 - Sophisticated order entry, delivery, inventory control systems

Composition of the U.S. Retail Industry

Figure 9.1, Page 563



SOURCE: U.S. Census Bureau, 2008

E-commerce Retail: The Vision

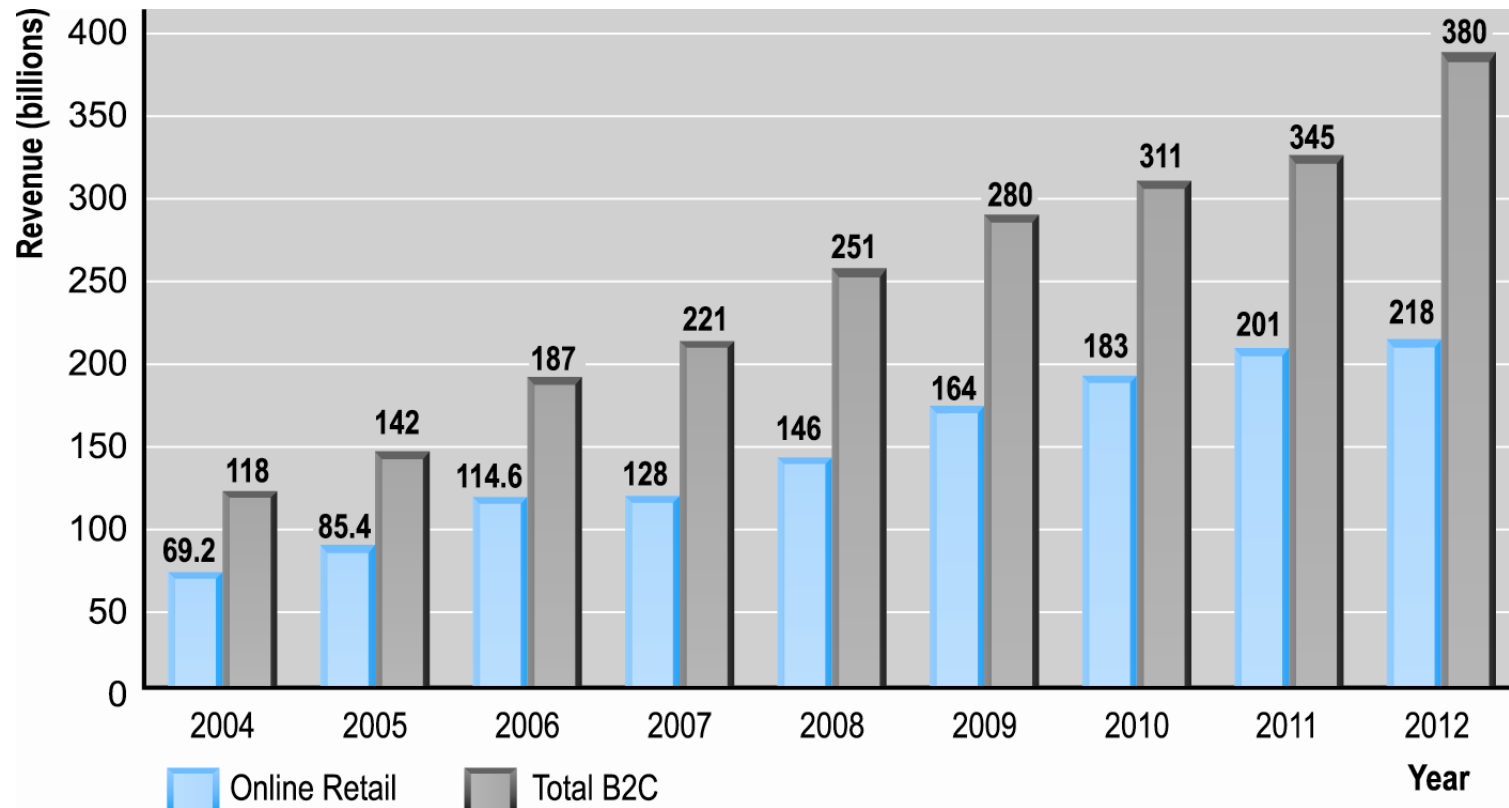
- Greatly reduced search and transaction costs would result in customers using Web to find lowest prices
- Market entry costs would be much lower than those for physical storefronts, and online merchants would be more efficient than offline competitors
- Traditional offline physical store merchants would be forced out of business
- Some industries would become disintermediated as manufacturers built direct relationship with consumer
- Few of these assumptions were correct—structure of retail marketplace has not been revolutionized
- Internet has created new venues for multichannel firms and supported a few pure-play merchants

The Online Retail Sector Today

- Online retailing segment, although smallest segment of retail industry, is growing at exceptionally fast rate
- Online retail revenues: \$146 billion in 2008
- Primary beneficiaries of growing consumer support: Established offline retailers with an online presence as well as first mover dot-com companies
- Top online retailers: Amazon, Staples, Office Depot, Dell, HP, Office Max, Apple, Sears

Online Retail and B2C E-commerce is Alive and Well

Figure 9.2, Page 566



SOURCES: eMarketer, Inc. 2008a; U.S. Department of Commerce, 2008; Forrester Research, 2008; authors' estimates.

Multi-Channel Integration

- Ability of offline traditional firms to integrate Web operations with physical store operations
- Provides integrated shopping experience
- Leverages value of physical store
- Examples: Wal-Mart, Target , JCPenney
- Types of integration
 - Online order, in-store pickup
 - Online order, store directory and inventory
 - In-store kiosk or clerk Web order, home delivery
 - Web order, in-store returns, adjustments

Analyzing the Viability of Online Firms

- Economic viability: Ability of firms to survive as profitable business firms during a specified period (i.e. 1-3 years)
- Two business analysis approaches:
 - Strategic analysis
 - Focuses on both industry as a whole and firm
 - Financial analysis
 - How firm is performing
 - Statement of operations: How much money (or loss) the firm is achieving based on current sales and costs.
 - Balance sheet: How many assets the firm has to support its current and future operations.

Strategic Analysis Factors

- Barriers to entry
- Power of suppliers
- Power of customers
- Existence of substitute products
- Industry value chain
- Nature of intra-industry competition
- Firm value chain
- Core competencies
- Synergies
- Technology
- Social and legal challenges

Financial Analysis Factors

- Factors in assessing Statements of Operations
 - Revenues: Growing and at what rate? $\text{Growth} = (\text{Year2} - \text{Year1}) / \text{Year1}$ or $= (\text{Year2} / \text{Year1}) - 1$
 - Cost of sales: Compared to revenues
 - Gross margin: Gross profit divided by net sales
 - Operating margin: Indication of company's ability to turn sales into pre-tax profit after operating expenses are deducted
 - Net margin: Net income divided by net sales or revenue
 - Net Annual Income Growth

E-tailing Business Models

- Four main types of online retail business models:
- Virtual merchant
 - Single channel Web firms that generate almost all revenues from online sales
 - e.g. Amazon
- Bricks-and-clicks
 - Companies with physical stores as primary retail channel, but also online offerings
 - e.g. Wal-Mart, J.C. Penney, Sears

E-tailing Business Models (cont'd)

■ Catalog merchant

- Established companies that have national offline catalog operation as largest retail channel, but also have online capabilities
- e.g. Lands' End, L.L. Bean, Victoria's Secret

■ Manufacturer-direct

- Single or multi-channel manufacturers who sell directly online to consumers without intervention of retailers
- e.g. Dell

E-commerce in Action: Amazon.com

- Vision: Earth's biggest selection, most customer-centric ,
- Business Model: Amazon Retail and Amazon Services (merchant and developer services): Retail, Computer power utility, Mall, Order fulfillment.
- Financial Analysis <http://finance.yahoo.com/q/is?s=AMZN&annual>
- Strategic Analysis/Business strategy: Maximize revenue, cut costs, same day shipping in Manhattan
- Strategic Analysis/Technology: Largest, most sophisticated collection of online retailing technologies available
- Strategic Analysis/Social, Legal: Antitrust, sales tax, patent lawsuits; Toys'R'Us lawsuit
- Future Prospects: Long-term profitability still uncertain (38% sales growth in 2008).

Common Themes in Online Retailing

- Online retail fastest growing channel, has fastest growing consumer base, growing penetration rate across many categories of goods
- Many online retail firms have begun to raise prices
- Disintermediation has not occurred, and most manufacturers use Web primarily as an informational resource
- Most significant online growth has been that of offline general merchandiser giants who are focusing on extending brand to online channel
- Second area of rapid growth: specialty merchants



Insight on Technology
Using the Web to Shop ‘Till You Drop
Class Discussion

- What do shopping bots and comparison sites offer consumers?
- Why are shopping bots more successful with hard goods than soft goods?
- What is the strategy of Shopping.com?
- How can shopping bots compare luxury goods?
- How will adding content to comparison sites help consumers?

The Service Sector: Offline and Online

- Service sector: Largest and most rapidly expanding part of economies of advanced industrial nations
- In the United States, services employs about 76% of labor force; accounts for \$7.7 trillion of GDP in 2008

What are Services?

- Service occupations:
 - Concerned with performing tasks in and around households, business firms, and institutions
- Service industries:
 - Provide services to consumers, businesses, governments, and other organizations
- Major service industry groups:
 - Finance, insurance, real estate
 - Travel
 - Professional services
 - Business services
 - Health services
 - Educational services

Categorizing Service Industries

- Within service industry groups, can be further categorized into:
 - Transaction brokers
 - Hands-on service provider
- Services industry features:
 - Knowledge- and information-intense, which makes them uniquely suited to e-commerce applications
 - Amount of personalization and customization required differs depending on type of service

Online Financial Services

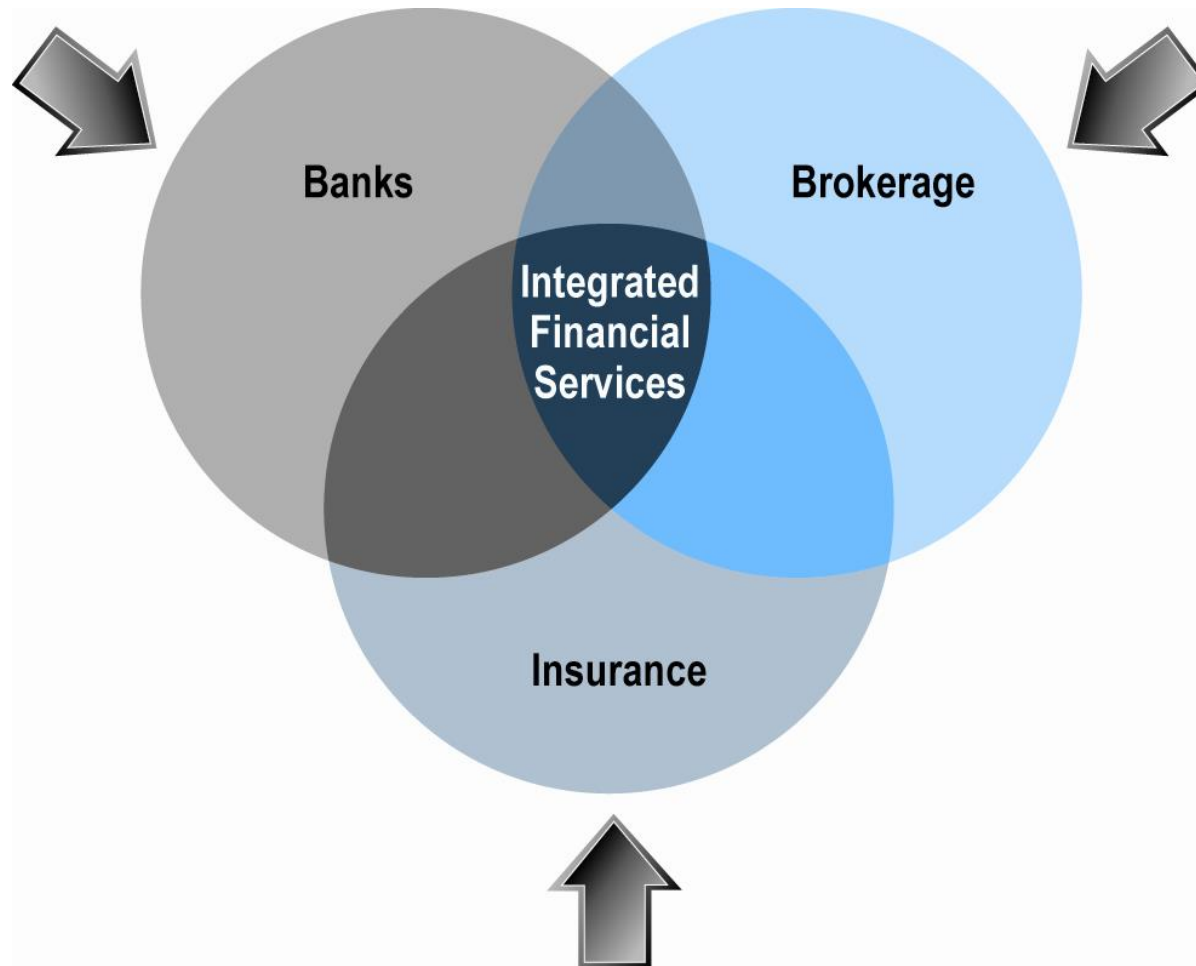
- Online financial services sector example of e-commerce success story, but success is somewhat different from what had been predicted
- Brokerage industry transformed
- Effects less powerful in banking, insurance, real estate
- Multi-channel established financial services firms are showing fastest growth and strongest prospects

Financial Service Industry Trends

- Four generic kinds of financial services:
 - Storage of and access to funds
 - Protection of assets
 - Means to grow assets
 - Movement of funds
- Two important global trends
 - Industry consolidation
 - Financial Reform Act of 1998 amended Glass-Steagall Act and allows banks, brokerages, and insurance firms to merge
 - Movement toward integrated financial services
 - Financial supermarket model

Industry Consolidation and Integrated Financial Services

Figure 9.3, Page 592



Online Financial Consumer Behavior

- Consumers attracted to online financial sites because of desire to save time and access information rather than save money
- Most online consumers use financial services firms for mundane financial management
- Greatest deterrents are fears about security and confidentiality

Online Banking and Brokerage

- Online banking pioneered by NetBank and WingSpan
- Established brand name national banks have taken substantial lead in market share
- Over 90 million people use online banking; expected to rise to 159 million in 2012
- Early innovators in online brokerage (E*Trade) have also been displaced by established brokerages (Fidelity, Schwab)
- Movement toward online banking is global

Multi-channel vs. Pure Online Financial Service Firms

- Online consumers prefer multi-channel firms with physical presence
- Multi-channel firms
 - Lower customer acquisition, conversion, and retention costs
- Pure online firms
 - Rely on Web sites, advertising to acquire customers
 - Users utilize services more intensively
 - Users shop more, are more price-driven and less loyal

Financial Portals and Account Aggregators

■ Financial portals

- Provide comparison shopping services, independent financial advice and financial planning
- No financial services, revenues from advertising
- e.g. Yahoo! Finance, Quicken.com, MSN Money

■ Account aggregation

- Pulls together all of a customer's financial data at a personalized Web site
- Yodlee: Leading provider of account aggregation technology; used by Merrill Lynch, Chase, etc.
- Raises issues about privacy and control of personal data, security, etc.

Online Mortgage and Lending Services

- Early entrants envisioned market in which mortgage value chain would be simplified, process speeded up, with cost savings passed on to consumer
- However, many of early-entry, pure online firms failed due to difficulties of developing brand and simplifying mortgage generation process
- Three kinds of online mortgage vendor today
 - Established online banks, brokerages, and lending organizations
 - Pure online mortgage bankers
 - Mortgage brokers
- Online mortgage industry has not transformed process of obtaining mortgage

Online Insurance Services

- Online term life insurance:
 - One of few products for which Internet lowered search costs, increased price comparison, and resulted in lower prices
- Other insurance product lines:
 - Web gives insurance companies new opportunities for product and service differentiation and price discrimination
 - Online use is more for discovering prices and terms of policies than purchasing policies online
 - Reduced search and price discovery costs
- Online insurance industry affected by fact that industry is regulated at state as opposed to federal level

Online Real Estate Services

- Early vision: The historically local, complex, and agent-driven real estate industry would be transformed into a disintermediated marketplace where buyers and sellers would transact directly
- However, major impact is influencing of purchases offline
 - Impossible to complete property transaction online
 - Main services are online property listings, loan calculators, research and reference material
- Despite revolution in available information, there has not been a revolution in the industry value chain

Online Travel Services

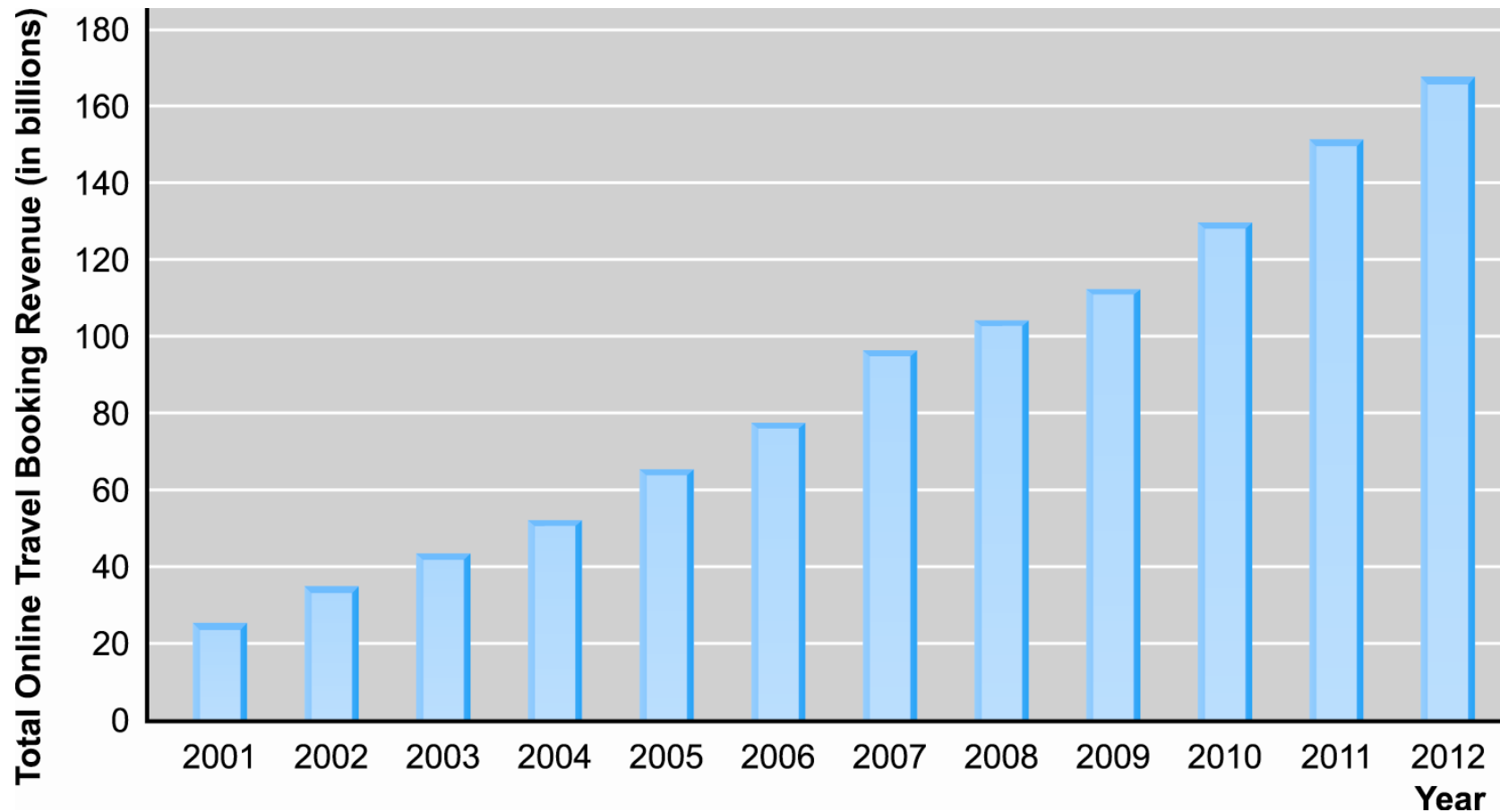
- One of most successful B2C e-commerce segments; attracts largest audience and slice of B2C revenues
- Internet becoming most common channel used to research travel and book reservations
- 2007: First year online bookings greater than offline
- 2008: Online travel bookings \$105 billion; expected to grow to \$162 billion by 2012
- Popular because they offer more convenience (one-stop content, commerce, community, customer service) than traditional travel agents
- For suppliers, offers a singular, focused customer pool that can be efficiently reached

Online Travel Services (cont'd)

- Travel an ideal service/product for Internet
 - Information-intensive product
 - Electronic product—travel arrangements can be accomplished for the most part online
 - Does not require inventory
 - Does not require physical offices with multiple employees
 - Suppliers are always looking for customers to fill excess capacity
 - Does not require an expensive multi-channel presence

Online Travel Services Revenues

Figure 9.5, Page 607



SOURCE: eMarketer, Inc., 2008c

The Online Travel Market

■ Four major sectors:

- Airline tickets:
 - Source of greatest revenues
 - Tickets as a commodity
- Hotel reservations
- Car rentals
- Cruises/tours

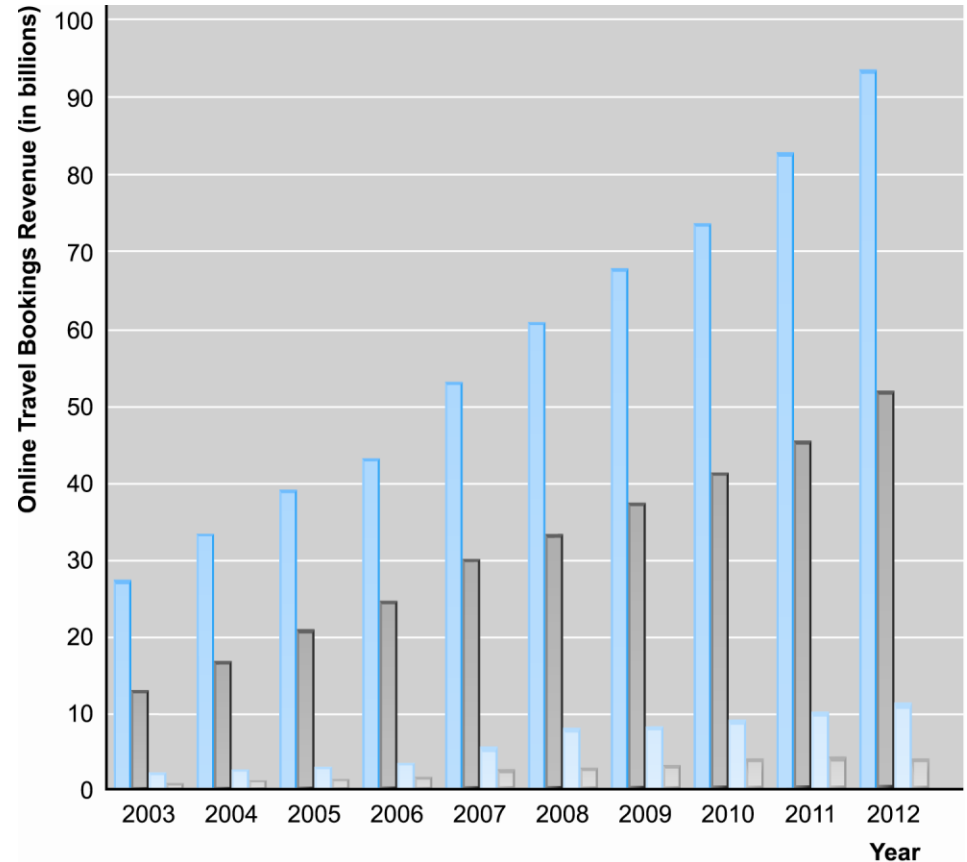
■ Two major segments:

- Leisure/unmanaged business travel
- Managed business travel – expected to be a major growth area as corporations seek better control of corporate travel expenses

■ Corporate online-booking solutions (COBS)

Projected Growth of Online Travel Market Segments

Figure 9.6, Page 608



■ Air	26.9	32.8	38.5	42.6	54	61	67	74	84	94
■ Hotel	12.6	16.4	20.5	24.1	30	34	37	41	46	52
■ Car	2.0	2.3	2.7	3.2	7	8	8	9	10	11
■ Cruise/tour	.6	.9	1.1	1.4	2	2	2	3	3	3
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012

SOURCES: eMarketer, Inc. 2008c, 2007f, 2005b; authors' estimates.



Insight on Business
Zipcars
Class Discussion

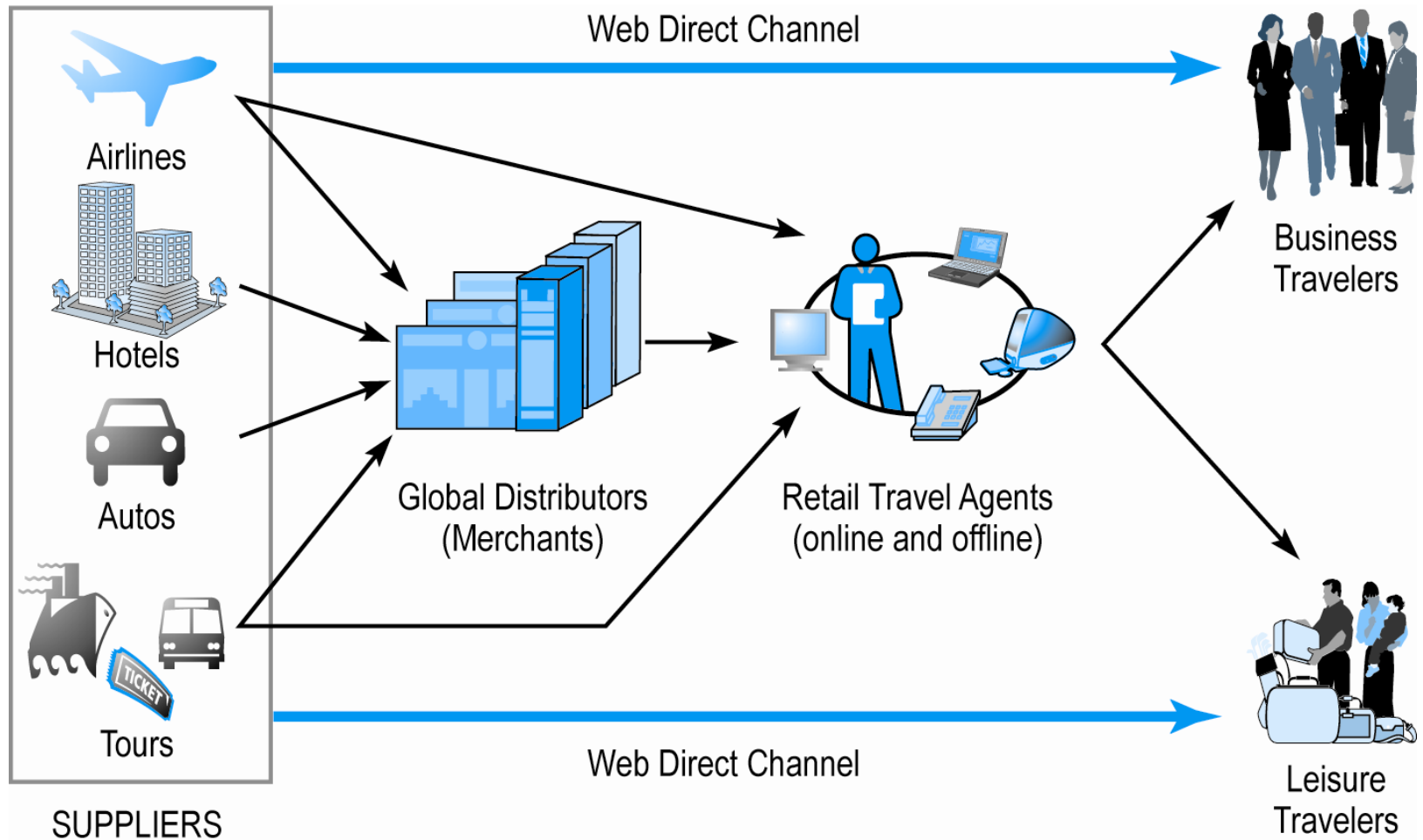
- What is the Zipcar business model? How does it make money?
- How does Zipcar use the Internet?
- Does Zipcar compete with traditional car rental firms?
- Will Zipcar work only in urban markets? Can it expand to the suburbs?

Online Travel Industry Dynamics

- Competition among online providers is intense
- Price competition difficult
- Industry has gone through period of consolidation as stronger, offline established firms purchased weaker and relatively inexpensive online firms
- Meta-search engines search Web for best prices, collect fees for providing consumer lowest price sites
- Suppliers (national airlines, hotel chains, etc.) are attempting to eliminate intermediaries—global distribution systems and travel agencies—using Web as means

The Travel Services Value Chain

Figure 9.7, Page 612



E-commerce in Action: Expedia.com

- One of top players in online travel services, generating revenues of \$2.7 billion in 2007
- Vision: Create global travel marketplace
- Business model: Agency model and merchant model
- Financial analysis: Assets catching up to liabilities
- Strategic Analysis/Business strategy:
 - Acquire complementary and competing travel companies, broaden scope of offerings, and expand into foreign markets, especially Asia

E-commerce in Action: Expedia.com

- Strategic Analysis/Competition
 - Other online commercial travel Web sites (e.g. Travelocity)
 - Direct suppliers of travel services
 - Suppliers of inventory
- Strategic Analysis/Technology
 - Developed a multi-layered platform capable of handling large transaction volumes, powerful search tools to assist consumers
- Strategic Analysis/Social and Legal
 - Former parent company
 - Taxation, international challenges, legislation on PII
- Future Prospects
 - Challenges: Economic conditions, cost control, competition

Online Career Services

- Next to travel services, one of Internet's most successful online services.
- Dominated by CareerBuilder, Monster, and Yahoo HotJobs
- Online recruiting provides more efficient and cost-effective method of linking employers and potential employees, while reducing total time-to-hire
- Enables job hunters to more easily build, update, and distribute resumes while gathering information about prospective employers and conducting job searches
- Ideally suited for Web due to information-intensive nature of process

Why are Job Sites So Popular?

- Saves time and money for both job hunters and employers
- For employers:
 - Expand geographic reach of search, lower cost, and result in faster hiring decisions
- For job seekers:
 - Make resumes more widely available, and provides a variety of related job-hunting services
- One of most important functions: Ability to establish market prices and terms (online national marketplace)

Recruitment Market Segments

- Three major segments
 - General job recruitment:
 - Largest segment and primary focus
 - Executive search:
 - Highest revenue potential
 - Specialized job placement services:
 - Often run by professional societies

Online Recruitment Industry Trends

- Consolidation:
 - CareerBuilder, Monster, and HotJobs together dominate the market
- Diversification: Niche employment sites
- Localization:
 - Local boards compete with local newspapers, Craigslist
- Job search engines/aggregators:
 - “Scraping” listings: Indeed.com, JobCentral
- Social networking:
 - LinkedIn; Facebook apps

Homework #2 - Due Tuesday 3/24

- Print the Income Statements of Walmart, JC Penney, and Travelocity.com for the past three years (2005-2008). Visit Yahoo Finance or other financial Websites to get the information.
- From the above companies and Amazon.com what are the impacts of the recession of 2008 on each company? Hints: Compute the income and revenues growth rates (by percent) of 2006-2007 and 2007-2008. Did the rates slow down in 2008?