

YOUR E-COMMERCE STRATEGY

Consumer behavior should be the principal determining factor of corporate e-commerce strategy. While technology will improve, consumer loyalty, for example, is likely to differ significantly between online booksellers and providers of financial services. Two factors seem critical in predicting behavior and determining an appropriate e-commerce strategy.

First, what is the duration of the relationship between buyer and seller? That is, does the buyer have a relationship with a favorite seller, in which they come to learn about each other, or does the buyer search for a different electronic vendor for each interaction? The former suggests an opportunity for tuning offerings; the latter precludes stable relationships.

Second, what is the scope of goods and services linking buyer and seller? Does the consumer purchase a single good or service, or a bundle of related goods and services? The former suggests the consumer searches for the provider of the best individual goods and services, while the latter suggests a search for the best provider of a collection of goods and services.

Combining these indicates that different companies, in different industries, will find themselves in one or more of four competitive landscapes.

Consumers buying products that can be described as opportunistic spot purchases exhibit no loyalty; each purchase may be from a different vendor and there is no one-stop shopping.

They may buy a ticket from British Airways one day and United the next, and book their hotels separately.

Opportunistic store markets occur when consumers exhibit no loyalty to brands or stores.

Unlike the spot market, however, they do use intermediaries to construct bundles of goods.

They may shop at Sainsbury one day and Tesco another; they may use Amazon.com one day and Buy.com another.

Consumers buying in categories that may be described as loyal links exhibit continuity when choosing vendors and service providers, but have no desire to have bundles prepared for them.

They may never leave home without their American Express cards, but see no reason for their card issuer to be their insurance provider or financial planner.

Finally, consumers buying in categories that may be described as loyal chains will have preferred providers. Additionally, they will count on these providers for a range of tightly coupled offerings. They may work with a financial consultant at Merrill Lynch who helps pick stocks, draft a will, arrange guardians for their children, find a lawyer, and review their insurance. The integrated services are so effective they seldom consider switching providers.

Each of these environments has a different competitive feel, and requires a different strategy and use of different assets. This is as true in the physical world, where companies understand it pretty well, as it is in the dot-com world, where companies are struggling to develop profitable strategies.

Note that no e-commerce company [operates in just one environment]. There are, for instance, loyal link customers, and companies may pursue them with loyal link strategies. But in reality some customers may use a Web site for spot purchases and others may show great loyalty. The challenge for companies is to guide the consumer to the behavior matching the company's strategy; where this is not possible, companies should match the strategy to the customer's behavior. The approach given here may help managers discover the forces that determine their best strategy.

Opportunistic Spot Markets

Competition in opportunistic spot markets is based on price, since there is little loyalty to influence consumers' decisions. This brutal competition is exacerbated by nearly perfect Web-based information. Thus, for standardized products such as the latest Harry Potter book, we observe both Amazon.com and BN.com selling at cost price. Where possible, companies try to soften competition by creating quality differences and ensuring consumers are aware of them. However, this branding must be based on real differences, since with nearly perfect information it is difficult to deceive consumers. There is a limited role for intermediaries. They may reduce risk in conducting transactions, but in most instances, consumers will buy from a set of trusted, well-known manufacturers and service providers.

The Internet will be used for supply-chain management and logistics to ensure the lowest cost structure and prices. It will also support access to information on consumers, both current and potential new accounts, to allow the most accurate setting of prices. That means no applicant for insurance can be undercharged based on inaccurate risk assessment and no applicant for a credit card can be given too good a deal. In a market where no one can be overcharged without losing the account, there is little margin for error and little opportunity to recover from under-charging anyone. The ability to predict the profitability of a new customer, and so to determine a price to offer, is called predictive pricing.

It is essential to recognize consumers exhibiting opportunistic spot market behavior and to develop an appropriate marketing and pricing strategy. For

example, in markets that exhibit this behavior, buying market share is unwise since it can be acquired only temporarily; when prices are raised to cover losses, customers will flee. Similarly, a policy of offering selected items below cost as loss leaders to attract traffic will be unwise, because consumers may easily purchase loss leaders from one site and the rest of their items elsewhere. Only time will tell whether the market for books, CDs, or DVDs exhibits this behavior, so it is too early to assess the validity of Amazon.com's customer acquisition strategy or the promotional items of other Web retailers.

Opportunistic Store Markets

In the absence of consumer loyalty, competition in opportunistic store markets again is based on price; however, it is the pricing of bundles rather than individual items that attracts consumers. Unlike spot markets, there are opportunities for intermediaries to add value, through logistical savings (shipping a box of books), or through assembly or integration (selling a package tour or designing a digital imaging platform where camera, printer, and computer work together).

In this scenario, intermediaries enjoy power over manufacturers because consumers select bundles with little attention to components. Thus, when filling an order for paper towels, a grocer will use the product with the highest margins. This pursuit of margins, in the absence of brand loyalty from customers, shifts economic power to intermediaries.

Manufacturers will attempt to use the Web for branding, to create consumer awareness of product differences and to weaken intermediaries' power. While it is dangerous to antagonize the existing channel in the opportunistic store scenario by trying to sell directly, branding offers manufacturers the ability to counter some of the power of intermediaries. As in the spot markets, manufacturers will also use the Internet to improve efficiency. Intermediaries will use the Internet to create branding for their Web stores, thus weakening price competition.

They will use customer information, as manufacturers did in spot markets, for predictive pricing.

As in spot markets, no consumer can consistently be overcharged, so it is difficult to recover from undercharging anyone. While loss leaders can work in these markets, since a customer may fill a basket or obtain a bundle of services, there is little loyalty to assure repeat business; thus, as in spot markets, buying market share is risky since there is no assurance that initial losses can be recouped by overcharging for later purchases.

Of course there may be reasons to buy share in a "scale-intensive" industry where volume is needed to bring down unit costs. Indeed, some aspects of online retailing, such as grocery shopping, may be extremely scale-intensive, which could initially appear to justify buying share. However, without customer loyalty,

the danger is that capital will be spent more on training users to accept online shopping and less on training users to accept your online shop.

Loyal Link

Competition in loyal link markets is based on retaining the best customers through a careful blend of service and pricing. For the customer, relationship value and pricing improve over time. For example, anecdotal evidence suggests online PC seller Dell has succeeded in creating loyal link behavior in customers, many of whom have bought several generations of computer from Dell.

In fact, no incumbent should ever lose desirable business to an attacker. If a less well-informed competitor were to attempt to persuade a loyal customer to transfer his or her business, the current supplier could decide whether or not to match the new offer. If the current supplier, with its detailed knowledge, were to choose not to match the new offer, odds are that the new supplier is making an offer that is too low. Successful attempts to get customers to switch in loyal link markets probably represent pricing mistakes by the attacker.

Relationship pricing and value work to soften pure price competition in loyal link markets.

Buying market share will work under certain conditions, since it is possible to learn enough to price effectively. However, buying market share is ineffective without loyalty, as online brokerage firms are discovering; so it is critical to assess whether the company is operating in an opportunistic spot or loyal link market.

Using loss leaders in a link market will be unrewarding; offering online banking below cost to gain credit card business is unlikely to succeed in a link market, where customers will pick the best hotel and the best air service, or the best online banking and the best credit offers, independently.

Systems will be used for branding and attracting customers and to support relationship pricing and service to keep the best accounts. These markets may appear to have only a limited role for intermediaries; however, intermediaries enjoy an advantage in controlling customer information and may end up owning customer relationships.

Loyal Chain

Competition in loyal chain markets, as in loyal link markets, is based on attracting and retaining the best customers and, as in loyal link, relationship value and relationship pricing improve over time. However, in chain markets, which are composed of a tightly coupled set of links, pricing to individual customers and the value they receive are determined by a bundle of goods and services.

Taking the earlier example of the digital-imaging platform, it may not be necessary to replace all components when upgrading. However, if buying a higher-resolution camera and a faster laptop, it is helpful to determine if the new computer and the old printer are compatible, otherwise the customer may experience an unpleasant surprise if picking and choosing components in a spot or link fashion. If the previous chain supplier is used to update the components, unpleasant surprises are likely to be avoided, since his vendor can be relied upon to provide components that are compatible with those bought before. Evidence suggests Amazon has succeeded in encouraging a degree of loyal chain behavior from its best customers, who value the book recommendations made to repeat buyers.

Loyal chain markets represent a power shift from producers to intermediaries. Online intermediaries can reconfigure the virtual store to show loyal purchasers the brands they wish to see; customers without a preference can be shown brands that earn the highest margins. Indeed, it is a small step from this relationship-based presentation to demanding rebates from manufacturers to ensure that their offerings will be shown to customers with no brand preference. While physical stores charge a fee for preferred locations such as displays near checkouts, they cannot reconfigure the store for each customer.

This shift in online power greatly increases the importance of branding for manufacturers, because a powerful brand is the best counter to pressure from retailers. It also suggests that, to the extent permitted by legislators, manufacturers should form consortia for Web retailing. This would avoid loss of control to retailers with significant information advantage. However, a broad consortium is needed since online markets reward scope and breadth.

Intermediaries may effectively buy market share through low pricing, enabling them to pursue informed relationship pricing over time. Likewise, they may use loss leaders to increase traffic through their Web site, selling other items to consumers interested in a complete bundle.

Systems play many roles in chain markets. Intermediaries will use them for branding, to attract customers and for informed relationship pricing and service. Likewise, manufacturers will use the Internet for branding, so limiting price pressure from online retailers. However, efficient markets still place significant price pressure on retailers, assuring the role of systems for logistics and other forms of cost control. Likewise, manufacturers and service providers will use the Web for their own cost control.

Conclusions

Three observations are true across all four competitive landscapes:

- Only differences between brands, and consumer awareness of them, can blunt pure price competition in an efficient market.

- Cost control is important: Efficient access to information makes it almost impossible to overcharge.
- As online information makes markets more efficient, predictive pricing will be used in spot and store markets, and relationship pricing in link and chain markets. Pricing strategies will be limited by adverse publicity that companies receive from charging different prices for the same goods.

Other conclusions follow from these:

- The role of buying market share will vary. In opportunistic markets, buyers will leave when you raise prices.

Similarly, the role of loss leaders will vary. In spot and link markets, consumers will pick off loss leaders and do the rest of their shopping elsewhere. Once customer traffic has been acquired, there is a chance to sell extra items.