Global Online Retailing
An Ernst & Young Special Report
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Executive Summary
Overall, consumers continue to be very satisfied with the online channel. While they are concerned with shipping costs and are price-sensitive generally, they continue to buy online in increasing numbers, and they are spending more on a greater range of merchandise categories.

To say that online retailing underwent a transformation in 2000 would be a major understatement. It was a year of devastating defeat for many pure-play e-tailers, and a year of caution — some would say retreat — for the investment community.

At the same time, it was a year in which companies recognized that online retailing is no longer an option: it is a business requirement. Numerous department store, broad-line, and consumer products companies brought their brand online, and many more click-and-bricks companies expanded their merchandise assortments online, catering to customers who are spending more on a wider range of product categories.

Certainly, this transformation is not over. As our research shows, we are in only the “second inning” of this game, and no doubt the industry will continue to transform itself in the years to come.

Ernst & Young’s significant findings

In October and November 2000, Ernst & Young researched consumers and retail companies in 12 countries. Overall, consumers continue to be very satisfied with the online channel. While they are concerned with shipping costs and are price-sensitive generally, they continue to buy online in increasing numbers, and they are spending more on a greater range of merchandise categories. Traditional brick-and-mortar companies, recognizing that online retailing is now a requirement, are moving aggressively into the channel, and they are optimistic about the future of multi-channel retailing.

Here are some of the more significant findings:

- More people are buying online. Of the consumers participating in our study, almost two-thirds worldwide have purchased items online in the past 12 months. More than three-quarters of German and U.K. respondents bought online in 2000, and 74% of U.S. consumers made online purchases last year.
- Consumers are making more online purchases, and shoppers worldwide are increasing their spending. Compared with a year ago, the number of online purchases has either increased or stayed the same for 97% of participating consumers worldwide. For some 96% of respondents worldwide, the total dollar volume of online purchases either stayed the same or increased compared with a year ago.
- Books, CDs, and computer equipment are still the top-selling products online, but consumers are beginning to move into new categories. “High-touch” products like apparel are beginning to make an impact and therefore represent a significant selling opportunity. Clothing ranks in the top five in the U.S. and
Canada. Other categories, like health and beauty products, sporting goods, flowers, and toys are beginning to show noticeably increased consumer shopping penetration.

- Multi-channel brands are becoming online favorites. While Amazon.com is still the consumers’ favorite site worldwide, several traditional brick-and-mortar retail brands are now in the top 10.

- Online shopping is beginning to affect store traffic. More than half of all shoppers say they visit the store less often because they shop online.

- As online retailing becomes more widely accepted, the demographic profile of the online shopper is beginning to look more like that of a “typical” on-land consumer. While male online shoppers still predominate outside the U.S., women now represent almost 60% of online shoppers in the U.S. and almost 50% of online shoppers in Canada and Australia. Average annual income has dropped, and education level is more in line with that of a middle-class consumer.

- While consumer acceptance is growing, it is clear that multi-channel retailing is still in an early stage of development. When asked about shopping online for high-cost, fragile, personal-sized, colored, perishable, and low-cost commodity items, no more than 38% of consumers said they were likely to shop online but to buy through another channel. Retailers have not yet learned to drive customers to different channels. Online shopping has not yet reached its cross-channel potential.

- Also, in some important ways retailers are not meeting customer expectations. Customers expect the same merchandise assortments online and in the store, yet only 44% of the companies we interviewed offer the same SKUs online and on-land.

- The majority of customers also expect to find lower prices online, yet they often do not. Compounding the problem, more than a third of companies interviewed worldwide have different pricing structures for their online and off-line operations.

- Customers are most displeased with shipping costs. As in previous years, shipping costs are the biggest concern of online buyers; it ranks as the number-one factor discouraging online buying and the number-one reason for abandoning a shopping cart. However, 89% of companies interviewed charge for delivery, and a small percentage, 11%, reported that they operate their delivery service as a profit center. While we the economic realities that retailers face, nevertheless they must find a creative solution to this issue.
Succeeding in multi-channel retail

To fully realize the great potential of multi-channel retailing, companies must offer an exceptional customer experience. Customers have very high expectations online — just as they do on-land — and their loyalty is very conditional. Success will depend on having a brand that enables them to meet and exceed customer expectations and improve the customer relationship.

Companies will also need a multi-channel strategy that enables them to integrate their online and off-line operations, ensuring a consistent, seamless experience for the customer across all channels.

Operational excellence is critical — in particular, having the technology and logistics systems that help them deliver service beyond the customer’s expectations.

Merchandising excellence is also essential; companies must provide consistent assortments and presentations and service in all channels.

Finally, companies must move at Internet speed, so that they can adapt quickly to consumer demands, technology developments, and rapidly changing business requirements.

Looking ahead

In the next few years, “branded” companies have an excellent chance to outdistance the competition. Consumers will log on in increasing numbers this year, and many will go to sites they know and trust — the big brand names, and not necessarily large companies.

The online channel will be substantial. By 2005, it will represent 10% to 12% of sales in such categories as apparel, accessories, and toys. In some categories, such as books, music, software, videos, and consumer electronics, it could represent as much as 20% to 25% of sales.

Experienced online shoppers have already proven that they will purchase virtually any product through this channel; “touch and feel” is not a major barrier, nor is size. The convenience of online shopping outweighs its shortcomings.

As technology develops, online shopping will become even more convenient. And companies will have tools that make it easier to sell every category of merchandise — especially the so-called “high-touch” categories like apparel, health and beauty, and luxury goods. Customers themselves will also change. Today’s “analog” generation will give way to a younger, “digital” generation that is being raised with computers everywhere in their lives. To them, shopping will just be shopping, whether it is online or on-land. Online and off-line retailing will simply be retailing, as technology and consumer acceptance enable a true blended model.

Companies will need a multi-channel strategy that enables them to integrate their online and off-line operations, ensuring a consistent, seamless experience for the customer across all channels.
Even five years from now, this industry will be nothing like it is now. Its promise, however, seems assured.

This year’s research and methodology
Our report is based on four sources of information: online and telephone consumer interviews, telephone interviews with companies, secondary research, and our own experience in the marketplace.

Online questionnaires were completed by 7,222 consumers in 12 countries: Australia, Brazil, Canada, France, Germany, Israel, the Netherlands, South Africa, Spain, Switzerland, the United Kingdom, and the United States. All respondents — except in Israel — were directed to a single Web site, where they had the choice of completing the questionnaire in English, French, German, Spanish, or Portuguese. This site was managed in the U.S. Israeli respondents were interviewed by phone.

In addition, we conducted telephone interviews with executives at 74 companies in the 12 countries listed above. These interviews covered the issues critical to success in online, and in particular multi-channel, retailing: branding, merchandising, online and on-land integration, pricing, site performance, order fulfillment, and technology. We also obtained financial information about these companies, as well as key business goals and objectives. Finally, we held discussions with a number of analysts and consulting experts to garner their insights and suggestions regarding current and future trends in the industry.
Consumer Trends in Online Shopping
Demographic profile shifts toward the middle

Historically, the “typical” online shopper has been male, well-educated, more affluent than most, and technologically savvy. According to our survey, all this is beginning to change. Demographically, the online shopper is becoming more like the typical middle-class retail consumer.

The average annual household income of online spenders in the U.S. has dropped to $52,300 this year from $59,000 in 1999. Outside the U.S., the average is even lower at $45,000. Overall, middle-class consumers are in the majority, with 58% of buyers in the U.S. and 69% of buyers outside the U.S. reporting annual incomes under $50,000.

Education level is also trending toward levels generally found in the population at large. More than half of respondents globally do not have a college degree.

Women shoppers making strides

Worldwide, men are still the dominant purchasers online, representing about two-thirds of the online shopping population outside the U.S. Men dominate the shopping scene to an even greater extent in Spain, where 85% of online shoppers are men. Germany and France are close behind with 84% and 81%, respectively. However, women now constitute almost 60% of the online shopping population in the U.S., up from 50% last year, and they represent almost half the online shopping population in Canada and Australia. We believe that what has happened in the U.S.

Demographics of online buyers

<table>
<thead>
<tr>
<th>Country</th>
<th>Age (Average)</th>
<th>Average annual household income (U.S.$)</th>
<th>Gender — % Male</th>
<th>% Female</th>
<th>Marital Status (% Married)</th>
<th>4 Year College +</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>42</td>
<td>$52,300</td>
<td>52%</td>
<td>48%</td>
<td>60%</td>
<td>53%</td>
</tr>
<tr>
<td>Brazil</td>
<td>34</td>
<td>$43,700</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Australia</td>
<td>36</td>
<td>$40,000</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Canada</td>
<td>36</td>
<td>$46,800</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>France</td>
<td>34</td>
<td>$51,300</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Germany</td>
<td>37</td>
<td>$41,300</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>37</td>
<td>$49,200</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>U.K.</td>
<td>35</td>
<td>$49,200</td>
<td>55%</td>
<td>45%</td>
<td>50%</td>
<td>40%</td>
</tr>
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* currency conversion rates found on page 9
will soon take place in the rest of the world, women will shop online in ever-greater numbers as online shopping becomes generally more accepted, as women become more comfortable with the online channel, and as product offerings online broaden.

Almost two-thirds of consumers bought online

The number of consumers using the Internet to purchase products continues to grow. Our data shows that almost two-thirds of consumers worldwide have purchased items online in the past 12 months, and more than three-quarters of German respondents bought online in 2000. Some 74% of U.S. consumers who responded said they bought online in 2000. Compared with a year ago, the number of online purchases has either increased or stayed the same for 97% of consumers worldwide and for 99% of European consumers. The U.K. and France had the highest percentage of buyers (86%) who had either somewhat or greatly increased their number of purchases, compared with 79% worldwide, and 77% in the United States.

With respect to the actual dollars spent, our data shows that for nearly all respondents (96%), the total dollar volume of online purchases either stayed the same or increased compared with a year ago. Nearly three out of every four respondents spent at least $100 online over the past 12 months, while 29% spent more than $500. Respondents spent, on average, between $700 and $900 online in six countries: Spain, Switzerland, Netherlands, U.K., France, and Germany.
U.S., Australia, France, Israel, the U.K., and Switzerland. Respondents in four countries spent an average of $500 to $700. South African and Brazilian respondents spent just under $500 on average. So far, however, most consumers have directed their online-buying activity to a relatively small number of favorite sites, purchasing items from only five to six sites on average. But the favorite sites of one respondent are generally different than the favorite sites of another. The marketplace is crowded and fragmented, and few companies have significant market share.

What they are buying

Globally, the so-called commodity products like books, CDs and computer equipment are still the top sellers. However, “high-touch” products like apparel are becoming much more important and therefore represent a significant selling opportunity. Apparel ranks in the top five in the U.S. and Canada. Other categories, like health and beauty products, sporting goods, flowers, and toys are beginning to show notably increased consumer shopping penetration.

This year, books ranked as the most popular online purchase in every country except Brazil and Canada, with 54% of all respondents and 52% of U.S. consumers reported purchases of books in the last 12 months. However, the demand for books is most pronounced in European countries, where they are purchased by almost three out of five online shoppers. By country, Germany leads in the book category with 70%, followed by the U.K. and Israel, with 65% each, and South Africa, 62%.

CDs and recorded music are in second place, purchased online by 48% of consumers. The biggest music aficionados are in Brazil, where 70% of purchases fall into this category, followed by the U.K, with 67%. Tied for third place are Germany and the Netherlands, with 53% each.

Food and drink account for 23% of purchases in the U.K., the only country to exceed 20% in this category, although France comes close with 18%. Flowers are most popular in Switzerland, where they account for one-fifth of purchases, compared with 13% in the U.S and 10% in the U.S. And consumers in Switzerland and Spain show the greatest interest in financial services, which make up 21% of online transactions.
Consumers in the U.S. are far more likely than shoppers in any other country to make online purchases of apparel (37%). The other countries where apparel filled up more than 20% of the shopping cart are the U.K. (28%), Canada (25%), and Australia (25%). Among buyers who have purchased clothing online, 95% of U.S. buyers and 94% of non-U.S. buyers expect to maintain or increase the amount they spend on apparel in the next 12 months.

Compared with consumers in all other countries, U.S. shoppers also show significantly greater inclination to buy toys, 28%; cosmetics, fragrances, and beauty items, 25%; sporting goods, 12%; and car rental reservations, 10%. But if past trends are any indication, consumers throughout the world are likely to follow the lead of U.S. consumers by venturing into a broader array of product categories.

**Online shopping affects store traffic**

Our research found that online shopping is already affecting traffic and sales at retail stores. More than half of all shoppers say they visit the store less often because they shop online. Only 7% of shoppers outside the U.S. and 4% of U.S. shoppers visit the store more often because they shop online.

In addition, respondents indicated that more than half of their online purchases, on average, ordinarily would have been made in a store or by phone. These findings suggest that brick-and-mortar retailers are losing sales to the online channel. However, consumers do not have a clear preference as to whether they buy online from Internet-only or click-and-mortar companies. More than half of respondents had no preference as to whether sites are Internet-only or part of a multi-channel business. About 30% prefer to shop at sites that have physical stores.

A minority of consumers said they were likely to shop online but buy in a store or by phone. When asked specifically about shopping online for high-cost items, fragile items, personal-sized items, colored items, perishable items, and low-cost commodity items, consumers were consistent: No more than 38% were likely to shop online but buy through another channel. We conclude from this that shopping has not yet reached its cross-channel potential.
Future growth seems assured
Looking to the future, there is no question that continued robust growth in online shopping seems assured. Virtually all consumers (97% worldwide and 98% in the U.S.) who have already purchased items online say they plan to continue their online buying, with a majority indicating that they expect to somewhat or greatly increase their purchases in the next 12 months. Among consumers who have not yet boarded the e-tailing bandwagon, 63% expect to do so in the next 12 months. South Africa, at 83%, shows the biggest jump in consumers who see online purchases in their future, followed by Brazil, at 80%; and Spain, at 77%.

Future sales of commodity products will be solid. The products most likely to be bought by consumers who have not yet shopped online, worldwide, in their order of popularity, are CDs/recorded music, 56%; books, 51%; computers and related products, 48%; tickets/reservations, 38%; videos/filmed entertainment, 29%; electronic and small consumer products, 28%; clothing, 23%; toys, 18%; and cosmetics/health and beauty aids, 16%. All other product categories came in under 15%.

But responses in the U.S. suggest that new product categories are emerging, perhaps anticipating the next wave of online retailing. In the U.S., the top eight products online shoppers expect to purchase are CDs/recorded music, books, computers, clothing, toys, tickets/reservations, videos, and cosmetics/health and beauty aids.

Online shopping outlook

<table>
<thead>
<tr>
<th>Country</th>
<th>% Buyers that intend to purchase in next 12 months</th>
<th>% Non-Buyers that intend to purchase in next 12 months</th>
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<tbody>
<tr>
<td>United States</td>
<td>98%</td>
<td>57%</td>
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<tr>
<td>Australia</td>
<td>97%</td>
<td>60%</td>
</tr>
<tr>
<td>Brazil</td>
<td>95%</td>
<td>63%</td>
</tr>
<tr>
<td>Canada</td>
<td>98%</td>
<td>50%</td>
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<tr>
<td>France</td>
<td>95%</td>
<td>65%</td>
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<tr>
<td>Germany</td>
<td>96%</td>
<td>69%</td>
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<tr>
<td>Israel</td>
<td>98%</td>
<td>50%</td>
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<tr>
<td>Netherlands</td>
<td>97%</td>
<td>67%</td>
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<tr>
<td>South Africa</td>
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<td>83%</td>
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<tr>
<td>Spain</td>
<td>95%</td>
<td>77%</td>
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<tr>
<td>Switzerland</td>
<td>98%</td>
<td>53%</td>
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</table>

Looking to the future, there is no question that continued robust growth in online shopping seems assured.

Currency conversion rates to U.S.$

<table>
<thead>
<tr>
<th>Currency</th>
<th>Rate</th>
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<tr>
<td>Australian Dollar</td>
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<td>Brazilian Real</td>
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<td>British Pound</td>
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<td>German Mark</td>
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<tr>
<td>Israeli Shekel</td>
<td>1.798</td>
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<tr>
<td>South African Rand</td>
<td>4.14</td>
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Source: Standard & Poor's Web site 10/29/00
Consumers express more concern about high shipping costs and apparel sizing than they do about prices. More shoppers abort their transaction because of shipping costs than for any other reason.

CONSUMER TRENDS IN ONLINE SHOPPING

Listen to the Consumer

The most exciting concepts may be yet to come in online retailing, but listening to customers and gaining their trust will remain fundamental.

By Peter N. Schaeffer, Managing Director, Retail & Consumer Products, Corporate Finance, United States

Despite the setbacks suffered last year in online retailing, we still believe the future of this business will be bright. In fact, it’s still very early in the game, and the most exciting winning concepts may still be ideas in the brains of future Web entrepreneurs. Who would have thought that Wal-Mart would become the largest retailer in the world when less than 10 years ago the chain was smaller than Kmart?

For anyone to win, however, they need to listen to the voice of the consumer — something that, unfortunately, few do. Most Internet business plans ignore consumer data, yet it is clear that purchase dynamics are substantially affecting sales results.

So what is the consumer saying? Why do they shop online? Most say they want to save both time and money. Many of the respondents in our survey say that saving time is their prime motivator, but ease of selection (57% globally) and competitive pricing (54% globally) dominate the online purchase decision. Convenience and price, then, are critical success factors, but winning online is also about merchandise assortment, customer service, trust, and execution.

Clearly, Amazon.com is delivering on many of these things, and consumers are responding. Amazon is the favorite site of 28% of all U.S. respondents in our report. With its broad merchandise assortments, relatively rapid site response, superior customer service, and competitive pricing, Amazon is meeting the demands of consumers.

Interestingly, as Amazon matures and learns to excel in ways that please the customer, the company has been able to reduce its dependence on low prices. Certainly, Amazon cannot arbitrarily raise prices, but it has slowly raised them while staying competitive. Amazon’s customers seem satisfied paying fair rather than deeply discounted prices, which may lead to the realization that consumers regard value as highly as they do price. It’s also interesting to note, however, that consumers express more concern about high shipping costs and apparel sizing than they do about prices. More shoppers abort their transaction because of shipping costs than for any other reason. Almost a third of all U.S. retailers interviewed use shipping charges as a profit center. They might
The recent integration of apparel manufacturers into direct Web selling, as well as the continuing incursion of traditional retailers into the online channel, has fueled the clothing surge.

Not be able to eliminate shipping charges, but they certainly should look at this incongruity. Changing this practice could go a long way toward pleasing the customer.

Easy purchases have always been the hallmark of the Net and, with the exception of apparel, consumers continue to support those areas where product variations do not exist. Still, two “new” product areas have shown significant growth — clothing and health and beauty aids. The recent integration of apparel manufacturers into direct Web selling, as well as the continuing incursion of traditional retailers into the online channel, has fueled the clothing surge. A refined Internet approach by most apparel catalog companies has also added to sales. Catalog retailers interviewed expect online sales to triple as a share of their business by 2005.

What’s next for online retailing? There is great potential for global selling, especially for U.S. companies. As our research shows, 58% of non-U.S. respondents buy from sites outside of their home country. There is also a major opportunity for traditional retailers with developed brands and consumer trust. In fact, we’re already seeing several of these companies moving into our list of favorite Web sites. These store-related sites may not be as technologically advanced as Amazon, or offer the low pricing and category assortments of CDnow or Buy.com, but they do have brand recognition and extensive physical store networks, which can be leveraged in many ways.

Will these sites mature and begin to produce profits for their parent companies? There are no guarantees, of course, but we believe the odds are in their favor. Don’t underestimate consumer trust.
“The physical world and the online world are coming together — they’re blending — and the winners will be those companies that create synergy between online and offline retailing.”

— Fred Crawford

The physical world and the online world are coming together—they’re blending—and the winners will be those companies that create synergy between online and offline retailing.

Fred Crawford

What is the outlook for online retailing by 2005, and what will drive the growth of this business? Who will win the battle for channel supremacy? Is the multi-channel model the best model? To explore these and other far-reaching questions, Ernst & Young spoke with four industry experts: Steve Barnett, Senior Partner at Ogilvy One and Visiting Senior Fellow of E-Commerce at the Wharton School of Business; Fred Crawford, Executive Vice President and Global Leader for Consumer Products, Retail & Distribution, Cap Gemini Ernst & Young; Ryan Mathews, Managing Principal, FirstMatter; and Anthony Noto, Vice President, Goldman Sachs & Co.

Stephanie Shern, Ernst & Young’s Global Director of Retail & Consumer Products, led the discussion. What follows is an excerpt from that discussion.

Stephanie Shern: It’s always difficult to predict the future, especially when you’re talking about a business that is influenced heavily by technology. But let’s try a four-year horizon. What percent of retail purchases will be made online by 2005?

Small shift, major consequences

Steve Barnett: Let me say something very simple to start, and that is: the question of raw percentage is not as important as the issue of how online sales affect revenues in the on-land channel — the “dirt world.” For example, in the supermarket sector, a shift of about 5% to the online channel would have devastating consequences for revenue. So, I think we have to look at percentages two ways. We have to look at the raw numbers, and we have to consider what numbers are likely to cause industry shakeout and fundamental change.

Anthony Noto: I agree. If you take Steve’s supermarket example: a 5% shift to the online channel could result in up to a 20% shutdown of physical stores, because you’re trading off profit dollars, and at the same time the on-land channel is losing a very desirable consumer cohort. The consumers that are likely to shift their purchasing online are the impulse shoppers and high-margin shoppers. The shoppers that are “left behind” are a less desirable demographic group — the no-frills shoppers with low or fixed incomes.

Fred Crawford: A larger point worth making here is that the physical world and the online world are coming together — they’re blending — and the winners will be those companies that create synergy between online and offline retailing.

Anthony Noto: That’s true, though the synergies you’re talking about will not work in every product category. I do not see a cross-the-board convergence of online and offline. In certain categories, the synergies between channels are critical, in other categories they’re not. According to studies we’ve done at Goldman Sachs, it depends on what the customer wants in a particular category.

Stephanie Shern: What segments would not be appropriate for multi-channel retailing?

Anthony Noto: Books, for one. There is no evidence that having both channels gives a company a competitive advantage in this category, primarily because the return rate is low, and the need to touch and feel is low. There isn’t a great benefit to having a...
“Broadband will have a significant impact because then you can sell high-touch products like apparel using fashion shows and the kinds of approaches that people are used to seeing on television.”

—Anthony Noto

physical location in books, because purchase behavior doesn’t dictate it. Consumer electronics retailers are probably in a better position because there is a buying benefit to having a physical outlet.

The categories that do not need touch and feel, that are not impacted by sizing or customization issues, are well adapted to the online channel and benefit far less from a blended model. Apparel and fashion items, which must conform to an individual’s characteristics, are well adapted to the on-land channel right now.

We estimate that 15% to 20% of retail rates will move online over the next 10 years. The decision to purchase online will largely be influenced by having an on-land presence.

The high-touch challenge

Stephanie Shern: Will the industry ever move beyond that? Will the Internet ever be a good channel for so-called high-touch products?

Steve Barnett: The industry certainly will move beyond that by 2005, with advances in interactive technology and imaging and other technologies. In England today, there are shops that have modified the United States Air Force technology, which custom-fits flight suits for pilots. It’s done by a series of laser measurements: the customer goes into a sizing booth, and the laser measures you at many points on your body. You never try a garment on.

Anthony Noto: I think broadband will have a significant impact because then you can sell high-touch products like apparel using fashion shows and the kinds of approaches that people are used to seeing on television. Technology will also help companies overcome barriers like customization and sizing. It will bridge touch-and-feel barriers, and add precision in terms of fit.

Fred Crawford: Another great example is facelabs.com, where you get your picture taken in a controlled environment, it gets scanned in, and your image is stored in a computerized environment. Now you can, in the privacy of your own home, try on different types of makeup in various combinations and intensities on your own face — online — until you get the combination that you like the best. Then you can order what you finally settle on.

Ryan Matthews: The next development, which is already here, has been created by a company called Eyematic. What they do is create a computerized image of your face that will also move as your face moves, provided you have a $12 camera sitting on top of your computer. So you can not only try on makeup but you can also see that makeup on your face online.

Stephanie Shern: So what we’re saying collectively is: as the technology goes, so too will be the ability to sell high-touch-type items. But aside from technology, what will be the keys to success in online retailing generally?

Winning with a blended model

Fred Crawford: The winners will be those companies that master the so-called blended multi-channel model. And with the possible exception of books, as Anthony noted, I think all categories lend themselves to a blended model. The spoils will go to the company that figures out how to
drive online traffic to the store, and how to
drive physical traffic to the online site.
And they will do that not only by selling a
product, but by selling context — by being
a retailer that consumers trust.
For that reason, I think Wal-Mart will be
the largest online retailer in the world, and
it won’t take them very long. And the pri-
mary reason is that Wal-Mart is a company
that consumers trust. We recently did a
survey, Stephanie, and Wal-Mart was the
favorite retailer in drugs, in convenience,
in pharmacy, in grocery, in mass merchan-
dise, and in specialty. They will eventually
integrate online and offline, and once their
target consumers go online in significant
numbers, Wal-Mart will have the strongest
online consumer franchise.
Anthony Noto: I agree that a multi-channel
strategy is a key to success, because land-
based retailers have three valuable assets:
strong brand names, large customer bases that
they can leverage, and relationships with ven-
dors, which not only provides a company with
great selection on their site, but also gives
them the opportunity to buy at a low cost.
But land-based retailers also need to devel-
op online merchandising skills, which are
different from on-land merchandising, as
well as Internet marketing savvy, which is
a convergence of traditional consumer
products marketing, retail marketing, and
direct marketing. As Fred said, land-based
retailers have the opportunity to cross-mer-
chandise the online store to land-based
customers and vice versa to drive
increased sales. Unfortunately, few of the
multi-channel retailers today have capital-
ized on these advantages.

Consumer Trends
in Online Shopping

“The spoils will go to the
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out how to drive online
traffic to the store, and
how to drive physical
traffic to the online site.”
— Fred Crawford

The battle for channel power

Stephanie Shern: Let’s shift gears for a
moment and look at the question of who
will control this channel. With branded
manufacturers selling direct to the con-
sumer, who will have the power?

Ryan Matthews: I would say the ultimate
driver is going to be the consumer, and
that this jockeying for digital power
between branded manufacturers and retail-
ers is clouding the issue. The key is
whether people will buy in your category.
So, to some degree, consumer purchasing
determines who wins the so-called power
struggle. On a more prosaic level, there’s
also the question of who moves first to
coeerce and control their channel partners.
We’ve seen plenty of examples of that
with retailers telling manufacturers, “Thou
shall not have a Web site that sells the
same products that we sell directly to the
consumer. If you do, we won’t carry your
products in our stores.”

Fred Crawford: Despite that, I think the
branded manufacturers have no choice but
to sell direct and online, for one simple
reason: The channel power continues to
consolidate around traditional retailers.
Consumers are stressed; they don’t know
whom to trust; they need someone to sim-
plify their lives; and therefore, they are
making selections at retail based upon who
can do a decent job of filtering for them.
So if the retailer is controlling the point of
consumer interaction, the brands become
less and less relevant. Manufacturers,
therefore, must become part of that filter-
ing process, or they themselves will
become irrelevant.
Ryan Matthews: And if a popular portal like AOL or Yahoo can control access to certain sites, what Fred said is even more true. If the portal can dictate terms to, say, Estee Lauder, the makeup referrals will go there as opposed to, say, Revlon.

The shape of things to come

Stephanie Shern: We say at Ernst & Young that online retailing is still young and immature. It’s only the second inning of this game, as it were, and a lot can happen and will happen. What are some of the major variables that could determine the future of this business?

Anthony Noto: I agree that we’re still at an early adopter stage. To get to mass-market adoption, consumers have to believe that when they go online to buy it’s going to be easy to do, there will be no security issues, returns will be done easily, and they’ll be able to find the products that they want. It’s about consumer satisfaction, and broadband will play a part in that. Broadband will increase the desire to go online. Once broadband reaches mass-market adoption — and companies provide high consumer satisfaction — online commerce will become part of the fabric of people’s lives.

Steve Barnett: As you say, Stephanie, a lot can and will happen. I think we’re witnessing the birth of an industry in which the early innovators tend to make the mistakes and lose money and the second wave of players cleans up. Will the next wave be the traditional retailers, an alliance, or something completely new? It’s hard to say. The best technology, the best model, may not have been invented yet.

Fred Crawford: I think online retailing will go mainstream when I can do things like order a meal with my cell phone and pick it up on the way home, order a video and pick that up too, and look like a hero to my family. When the online-offline blurring is complete — when I can’t tell the difference — it will go mainstream.

Ryan Matthews: I want to bet on three things, even in the limited time frame of 2005. One is: who has the technology that allows the best consumer interface, regardless of whether it’s a pure-play, traditional retailer, or branded manufacturer. Second, I want to bet on the average consumer — not the buffs, the debutantes. Once companies understand what mainstream consumers want online, the offerings will change significantly, and so will the opportunities in terms of scale.

Finally, I want to bet on generational change. I think we still apply a lot of analog thinking to the digital space. I think we do that because of how old we are, and because these technologies came to us as add-ons to our installed psychic infrastructure. People who have been born into this world of cyber-space will think about online retailing differently than we do. There are children who have never been to a toy store; buying toys online is second nature to them, just as computers are second nature to them. By 2005, we probably won’t feel this generational impact, but five or 10 years beyond that, we will. We’ll have a generation that will have grown up with computers, and online retailing will be a whole new ballgame.

“Once broadband reaches mass-market adoption — and companies provide high consumer satisfaction — online commerce will become part of the fabric of people’s lives.”

— Anthony Noto
The Multi-Channel Imperative
Online retailing is also the intelligence-gathering point for chains to acquire a keen understanding of consumer motives, behaviors, and preferences — knowledge they can then apply to make both their brick-and-mortar stores and Web sites more compelling.

Call it the new imperative: retailers must sell online. Evidence is mounting that multi-channel retailing is a compelling premise for every type of store operator in every product classification — books, music, apparel, health and beauty, grocery, full-line discounting, consumer electronics, and more — and in every size format. Consumers are demanding an online option, and it has become a competitive necessity. If you’re not selling online, shoppers will look elsewhere to make online purchases.

What does this mean for traditional and catalog retailers? Multi-channel retailers must give life to online stores that leverage the best aspects of their physical outlets — full assortments, competitive pricing, seamless service, easy transactions, rapid order fulfillment, and satisfaction guarantees. According to Walter Loeb, President of the retail consultancy Loeb Associates and advisor to Ernst & Young, “The success of Internet retailing is now in the hands of multi-channel retailers. Click-and-mortar retailing is no longer an option. It is an imperative.”

Multi-channel retailing is a business requirement

While still in an early stage of development, online retailing is clearly essential to the present and the future of retailing. It is the vehicle for commanding attention from consumers anywhere, anytime without geographic boundaries. Online retailing is also the intelligence-gathering point for chains to acquire a keen understanding of consumer motives, behaviors, and preferences — knowledge they can then apply to make both their brick-and-mortar stores and Web sites more compelling. Simply put, multi-channel retailing is a business requirement.

According to Ernst & Young’s research, during the past 12 months some 77% of online shoppers worldwide reported an increase in online spending, and 25% reported purchasing clothing online. Not only are more consumers beginning to spend more and shop in a wider range of categories, but 97% of global shoppers intend to continue shopping online, and the majority expects to spend more and buy more products in 2001. Without question, this indicates that consumers are beginning to accept electronic depictions of the fit, feel, finish, look, texture, sounds, and scents of a wide array of merchandise.

Another dimension to the multi-channel imperative is that pure-play e-tailers are finding that they also need to be multi-channel operators. The dot-coms have begun to branch out by using “old economy” ways to create brand awareness, obtain credibility, attract a wider customer base, and maximize sales. Direct mail, catalogs, and 800 numbers to call and order directly with a customer service representative are now commonly found in some...
More than 80% of consumer respondents worldwide will reach a Web site to make purchases by keying in the company name.

According to Walter Loeb, “Many virtual retailers with no connection with stores are seeking alliances with traditional retailers. It is becoming a competitive necessity, and the financial world is demanding that they enter into such joint operations to accelerate their path to profitability.”

Bringing the brand online

Multi-channel retailing entails several major challenges, however. One is brand extension — the ability to bring a likeness of the store marquee, the feel of the aisles, the touch of the goods, the scents and sights of the shopping experience, directly to customers 24/7 in their dens and living rooms, whenever it may be convenient to shop.

It is not an easy task for an e-commerce Web site to convey an image — the essential gestalt of a retailer — to establish the difference between, say, Sears and JCPenney, or between Bloomingdale’s and Nordstrom, or between Best Buy and Circuit City.

Nevertheless, it is important to get this right, because brand recognition is a huge issue for e-shoppers. Unlike the physical world, there’s no neighborhood proximity or shopping mall bringing people past an e-tail site. Two-thirds of shoppers researched rarely or never access an online shopping mall to get to a site. The recognition of brand is what inspires their visit — knowledge of your name and what it stands for, and possibly some prior successful purchases or attainment of knowledge there — which earn the site placement on consumers’ “favorites” list.

Consistent delivery of a brand message between the brick-and-mortar and online worlds is imperative to achieve this status. It’s so important because the vast majority of online shoppers access sites by company name, favorites file, or a search engine. More than 80% of consumer respondents worldwide will reach a Web site to make purchases by keying in the company name. Over 75% of respondents worldwide will click on a site from their favorites file or use a search engine such as Yahoo.

The Multi-Channel Imperative

Consumer expectations for merchandise assortment

<table>
<thead>
<tr>
<th>United States</th>
<th>U.K.</th>
<th>China</th>
<th>Japan</th>
<th>Korea</th>
<th>Germany</th>
<th>Israel</th>
<th>Netherlands</th>
<th>Spain</th>
<th>Switzerland</th>
</tr>
</thead>
<tbody>
<tr>
<td>About the same number of products available as the retail store</td>
<td>27%</td>
<td>27%</td>
<td>37%</td>
<td>25%</td>
<td>17%</td>
<td>25%</td>
<td>29%</td>
<td>42%</td>
<td>33%</td>
</tr>
<tr>
<td>About the same number of products, but also specials that are not available retail</td>
<td>51%</td>
<td>53%</td>
<td>48%</td>
<td>57%</td>
<td>58%</td>
<td>43%</td>
<td>48%</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>Less products than at the retail store or catalog</td>
<td>8%</td>
<td>4%</td>
<td>3%</td>
<td>2%</td>
<td>3%</td>
<td>7%</td>
<td>2%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>More products than at the retail store or catalog</td>
<td>18%</td>
<td>17%</td>
<td>34%</td>
<td>14%</td>
<td>18%</td>
<td>28%</td>
<td>30%</td>
<td>11%</td>
<td>31%</td>
</tr>
<tr>
<td>Entirely different range of products</td>
<td>2%</td>
<td>1%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>
Not only are consumers fixed on a few ways to reach their preferred sites, they’re very selective when shopping online. Ernst & Young research shows that respondents worldwide have bought from an average of about six Web sites over the past 12 months. This holds true in all 12 countries surveyed, ranging from an average of four to seven.

Consider all the categories in which people e-shop and that six sites boils down to just one in each product classification — whether it be sporting goods, apparel, health and beauty, toys or more. All of a sudden, the standard of excellence is set high for click-and-mortar operators, who need to be number-one online against their most direct competitors in order to win cyber-space competition.

Providing a seamless customer experience

Multi-channel retailers must also provide a seamless customer experience — the store channel and the online channel ought to be transparent to the customer. This is easier said than done. How do you get people to repeatedly shop at both sites and stores? How do you understand their wants and needs, and deliver on promises of assortment, price, and timely order fulfillment?

Click-and-mortar companies have yet to emerge with best practices, but clearly the winners will be the ones that make their sites as intuitive and personal as possible, and create customer experiences that closely parallel and reinforce what shoppers encounter in their stores. This requires multi-dimensional thinking about the ways consumers relate to their stores and merchandise, as well as their expectations on assortment, pricing, service, and shipments. Do people like to browse for some categories and purchase others quickly? Is there a pattern to how they navigate the site? Are they receptive to suggestive sells of companion products? Do they expect additional online specials?

Ernst & Young research findings answer some of these questions. By an overwhelming margin, e-shoppers worldwide say they expect to see “about the same number of products, as well as specials that aren’t available at retail” on the Web site. In all, 51% of consumers said they expected the specials as well, ranging from 40% in Israel to 61% in Spain.

However, there’s an obvious disconnect today between what customers say they want and what multi-channel retailers offer. Among companies surveyed by Ernst & Young, just 26% of U.S. compa-
nies reported that they offer the same products online, as opposed to 40% of the non-U.S. companies interviewed.

The challenge doesn’t end here, either. Click-and-mortar companies must fulfill orders the way people expect them to be fulfilled — meaning they must manage inventory, distribution, and logistics transparently and effectively.

Driving customer traffic

Another multi-channel challenge is perfecting strategies for driving customers to one channel or the other. There are obvious advantages to enticing customers to use more than one channel — increased sales, marketing leverage, cost efficiencies, and so on. Ernst & Young research shows, for instance, that companies see the online channel as important to such business objectives as driving revenue growth and store traffic.

However, the multi-channel game is not without risks — in particular, the risk of the online channel “cannibalizing” sales in the on-land channel. It is clear from Ernst & Young’s research that online sales are beginning to affect store traffic. Some 55% of e-shoppers said that “because I can shop online, I visit the retail store less often.” On the other hand, 43% claim they wouldn’t have made purchases if the merchandise they wanted wasn’t available on the Internet. This ranges from an incidence of 32% in the U.K. to 53% in South Africa, which, potentially, amounts to a lot of incremental business. Cannibalization is inevitable for traditional stores and catalogs, but is it too early in the development of this business to understand “to what degree?”

### The Multi-Channel Imperative

Cannibalization is inevitable for traditional stores and catalogs, but is it too early in the development of this business to understand “to what degree?”

<table>
<thead>
<tr>
<th>Importance to companies of online channel for various goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing</td>
</tr>
<tr>
<td>-----------</td>
</tr>
<tr>
<td><strong>United States</strong></td>
</tr>
<tr>
<td>3.5</td>
</tr>
<tr>
<td>3.7</td>
</tr>
<tr>
<td>3.1</td>
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<tr>
<td>3.7</td>
</tr>
</tbody>
</table>

Mean rating on a 4-point scale, with 4 meaning very important.
Organizational structure
Multi-channel retailers must also address the question of how best to organize the online entity. Should the online business be part of the core business, or should it be a separate entity? The need for organizational discipline might prompt retailers to consider setting up a separate online entity to manage itself. While that has some obvious operational advantages, it could sacrifice management of the brand, which is, after all, the overarching value of the business. It is worth noting that Ernst & Young’s research shows that catalog companies in the U.S. are generally more integrated than other sectors, and numerous catalogs have been successful at integrating their online and off-line channels.

The question of organizational structure — indeed, many questions about multi-channel retailing — has no definitive answer at the beginning of 2001. There are no clear best practices at this early stage of development. What is clear, however, is that multi-channel retailers have an opportunity to lead the way.
Multi-channel retailers have also found that their e-stores must come as close as possible to replicating the shoppers’ experience in their physical stores.

The Seamless Customer Experience

Providing a seamless customer experience means integrating operations, marketing, and merchandising.

In developing a multi-channel presence, perhaps the biggest challenge for traditional retailers is meeting and exceeding the expectations of e-customers sharpened by years of shopping in their stores. That may sound easy, but the execution of a consistent operational and merchandising strategy that rewards today’s cybershoppers with a no-hassles experience has been difficult to master. The litter of abandoned Web site shopping carts is a testament to the complexity of the task. To refine their efforts, chains must determine how often their online target customers are the same as on land, and whether they have the same shopping needs in both channels.

Integrating operations, marketing, and merchandising

Creating an agreeable online experience for e-customers requires traditional retailers to develop a different area of the retailing “brain” — and seamlessly integrate that new capability into all aspects of operations, marketing, and merchandising. This has proven to be a formidable test. Indeed, while their well-established brands give traditional “bricks” retailers a decided edge over their Internet-only brethren, it doesn’t guarantee them smooth entry into electronic retailing, as many powerhouse companies, including Wal-Mart, have found out.

Traditional retailers who’ve begun to master the intricacies of multi-channel integration have learned some important lessons. Most important: success requires creating a seamless shopping experience for customers, both online and at the actual store. Most shoppers are going to expect the store to be a single unit that keeps track of all transactions, whether made at the mall, online, or through a catalog, even though different databases may be in place for each channel. When shopping in a store, a customer expects to be able to purchase the merchandise that is featured. No different online, shoppers who go to the Web site expect to be able to online purchase the merchandise displayed.

Companies like Borders and Kmart have invested heavily in integrating their various customer databases into a single entity in a process known as channel synchronization. At Borders, when the process is completed the company will be able to track customer transaction histories across all of its divisions, and that will give Borders the ability to respond to customer queries about any previous purchase, no matter where made, and also to tailor its direct marketing efforts to individual customer tastes.
Replicating the store experience

Multi-channel retailers have also found that their e-stores must come as close as possible to replicating shoppers’ experience in their physical stores. That requires providing a high level of consistency between the merchandise assortments offered in both settings. Feeling the texture of a sweater or blouse isn’t possible online, of course, but the photographs of apparel and other items must be as sharp and revelatory as those of a catalog offering.

What’s more, the online experience has to be easy and stress-free: no interminable waits for complicated, multimedia graphics to load and no dead-ends as the customer navigates through departments and categories down to the particular brands and items desired.

For retailers to succeed online they must offer service levels that meet or exceed in-store standards. Shoppers almost invariably have questions about selected items; they have to be able to dial toll-free and reach a call center or engage in a live online chat with a knowledgeable service representative at any hour. They also need up-front information about all costs, including deliveries, and not be blind-sided at the checkout by unexpectedly high charges.

Easy returns

Customers must also be able to return purchases without difficulty and without being charged for the service, either by mail or at the store. The ability to return or exchange at the store is one of the competitive advantages expressed by the multi-channel retailers interviewed.

One of the Web sites that illustrate the concept of channel integration is Kmart’s bluelight.com. The company has gone to great lengths to produce an easy-to-navigate site that offers effortless access to all merchandise departments. It has also assembled its customer service offerings onto one page titled “customer care.” There, shoppers can click for detailed information — think of it as an online tutorial — including a step-by-step guide to ordering and instruction and how to return items by mail and at a Kmart store. The page also offers one of the most thoroughly informative lists of frequently asked questions available on the Web.

Nordstrom.com is another example of how integration between channels can work to improve retailer sales and profits — and reinforce a carefully nurtured brand image. When Nordstrom.com launched its redesigned Web site last August, it listed

When Nordstrom.com launched its redesigned Web site last August, it listed three essential ingredients it had set based on customer feedback:
1) the ability to shop and search for products with ease,
2) the ability to locate brands quickly, and
3) a fast and straightforward checkout process.
three essential ingredients it had set based on customer feedback: 1) the ability to shop and search for products with ease; 2) the ability to locate brands quickly, and 3) a fast and straightforward checkout process. The requirements were consistent with the high-service fashion image that the apparel retailer seeks to maintain throughout its chain of department and specialty stores.

The new Nordstrom site features simple navigation through a home page entry point and a search function on every page, live chat capability, and easy returns and exchanges either by mail or at a Nordstrom store, and easy registration and checkout functions. “Easy, convenient online shopping with a great selection is what our customers have told us they want,” said Dan Nordstrom, chief executive officer of Nordstrom.com.

While simple Web page design works best in creating a stress-free shopping experience, retailers have to be cautious that they’re not sacrificing some of the unique qualities of their real stores in an effort to speed customers through the online shopping process. FAO Schwarz, the specialty toy store, has made a special effort to transfer some of the excitement and feel of its flagship New York City store to faoschwarz.com. In the site’s virtual playroom, for example, a selection of toys can be viewed in three dimensions and full-throated sound, including a dinosaur that roars.

It may be a long while before online shopping is transformed into a “Matrix”-like experience of being in an actual store. But in the meantime, brick-and-mortar retailers have been making strides in making their customers’ online experience as rewarding as the one found in their stores.

FAO Schwarz, the specialty toy store, has made a special effort to transfer some of the excitement and feel of its flagship New York City store to faoschwarz.com.
Alliances: Is Blur Good for the Brand?

Strange but successful bedfellows may emerge as companies “pony up” in the new economy.

Companies will look to leverage their strengths with complementary companies in all areas of the organization including marketing, supply chain operations, customer databases, and finance.

If you shopped at Barnesandnoble.com in December 2000, you would have received the following email: “Congratulations! Your recent purchase at Barnes & Noble.com has qualified you to receive a Gap Code good for $10 off a $50 purchase at gap.com.”

In the same month, 39 million Sears credit card users got a chance to win shopping sprees if they signed up for America Online and paid with a Sears card.

Toys “R” Us teamed up with Amazon.com to sell its products through Amazon’s site.

Why would such “big brand” retailers enter into alliances like these? Aren’t they risking the integrity of their brands by “blurring” them in such co-marketing ventures?

The answer is yes, they are taking calculated risks. But they are risks worth taking. These alliance partners are not direct competitors, but they know they have synergies that can build business for each other. More important, they recognize that the winners in online retailing will use this new channel to create new ways to market their brand, and alliances are a critical part of this new thinking.

Companies today ask questions like, “What’s the boundary of the firm and how hard should that boundary be?” said Charles Conn, chairman of Ticketmaster Online/City Search. “It helps you think about things like whether to buy, build or partner.”

New alliances for a new channel

In fact, strategic alliances are being formed at a rapid pace, and this trend is expected to continue. Of the companies interviewed by Ernst & Young, 65% of non-U.S. and 75% of U.S. companies reported that they are already engaged in some form of strategic alliance. One reason for this is that competition is intensifying in many categories of online retailing. It is likely that a few major players will emerge to dominate every category, so companies are seeking competitive advantage by entering into the right strategic alliances. It will simply be impossible for a business to manage itself properly without considering numerous kinds of alliances.

Companies will look to leverage their strengths with complementary companies in all areas of the organization including marketing, supply chain operations, customer databases, and finance.

The Internet also gives rise to “crossovers” between entertainment, marketing, and commerce. This creates the need for technological solutions, which will in turn give rise to more alliances. Through alliances, companies are able to focus on core prod-
ucts, services, and business activities, and let partners do the rest. This could further spur business development. A network of partners can help multi-channel retailers lure incremental business while also managing production, technology, distribution, warehousing, shipping, and a host of back-office functions such as finance. But across-the-board, quality of product manufacture, customer service, timely order fulfillment, and easy returns must adhere to consistently high standards.

There are several types of alliances:

- Product and/or service alliances, where one company licenses another to make its product, or two companies jointly market their complementary products or a new product;
- Promotions, where one company agrees to carry a promotion for another company’s product or service, such as Sears/AOL;
- Logistics, which offer warehousing and/or distribution services; and
- Pricing collaborations, where companies offer mutual price discounts like rental cars and hotels or airlines.

In addition, the Internet makes possible new combinations that weren’t possible before: portal alliances; database collections, as between catalogs and credit card firms; co-branding; and virtual shopping malls. Any of these relationships can be short- or long-term, though the trend at the moment is toward short alliances. The multi-year, multi-million-dollar deals of just a year ago are rare, following in the wake of the shakeout among pure-play e-tailers.

Managing alliances but maintaining brand integrity

For multi-channel retailers, the question is not, should we consider alliances; it is, how do we manage our alliances effectively, without jeopardizing the brand? This is challenging, especially when the array of relationships grows complex. Ticketmaster’s Conn pointed out that among his company’s alliances, two were competitors, Yahoo and The Denver Post. “In the old economy, the question was, ‘Compete or buy?’ Now anything goes,” he said.

As a general rule, retailers have to weigh benefits and risks in evaluating partners for the short- and long-term. First, companies must understand their own asset strength and figure out how to leverage it through smart alliances with appropriate partners. This often leads to a cut in the number of suppliers, then treating the remaining ones as strategic allies, sharing information freely, and drawing on their expertise to develop new products that meet the quality, cost, and delivery standards expected by consumers, thereby enhancing brand equity.

As the Internet adds to an already complex business environment, multi-channel retailers can’t expect to meet their corporate objectives if they go it alone. Alliances offer viable solutions when partners complement each other.
Thirty-one publicly traded e-tailing companies were analyzed to determine which measures best explain enterprise value. Investors concentrated on two factors when evaluating these companies: gross profits and total visits.

Until the beginning of 2000, Wall Street analysts were convinced that sales were the most important driver of value in the e-tailing sector. They have since amended their thinking and have come to realize, as Ernst & Young has since 1999, that a different financial factor is at work in the valuation of e-tailers. An Ernst & Young study, “Value Drivers in the New Economy,” showed that as early as April 1999 investors were paying attention to gross profits, rather than sales, and had maintained a keen interest in profitability well into this year. Yet, as it turns out, gross profits tell only half the story.

What investors value
The purpose of Ernst & Young’s study, which is updated quarterly, is to identify objectively the performance measures most valued by e-commerce investors. The study analyzes several sectors of the e-commerce economy, including business-to-consumer e-tailing. For the e-tailing sector, 31 public companies were analyzed using a regression to determine which measures best explain enterprise value (market capitalization plus net debt). The period under study spans 18 months, beginning in the first quarter of 1999.

For the second quarter of 2000, we found that investors concentrated on two factors when evaluating e-tailing companies: gross profits and total visits — i.e., the total number of visits to the Web site of the e-tailer in question. These findings are summarized in the two figures below. Figure 1 shows a positive relationship between enterprise value and gross profits, controlling for the effect of total visits; and Figure 2 shows a positive relationship between enterprise value and total visits, holding

The Multi-Channel Imperative

Value Drivers in Online Retailing

Both profitability and traffic count with investors, not sales.

By Don Collat, Managing Partner and Chief Strategist, Corporate Finance
These so-called “real options” can be explicitly valued in much the same way one would value a traditional put or call option on financial security.

The study also found that investors have slightly different criteria when investing in smaller, less mature companies in this sector. Analysis of a sample that excluded large companies, such as Amazon.com and eBay, showed that investors are most concerned about the total amount of time spent on the Web site and the company’s capacity to survive without external financing.

The results of the Ernst & Young study highlight the two primary components of a company’s value. The first, and the most familiar, component is the traditional net present value (NPV). To compute NPV, an analyst estimates future free cash flows assuming that the company follows a pre-determined course of action. These cash flows are then discounted at an appropriate rate.

A second, and often significant, component of enterprise value is frequently overlooked, however. This second component is linked to management’s flexibility — its ability to make mid-course corrections once new information becomes available. Such corrections would include decisions to abandon, redirect, defer, or expand a project. These so-called “real options” can be explicitly valued in much the same way one would value a traditional put or call option on a financial security.

The results of the e-tailing study support the theory of real options. The study identified the two measures that investors care about most in evaluating e-tailers. One of those measures, gross profits, is strictly financial and comports well with NPV. Yet a traditional NPV analysis cannot account for the presence of the other measure, total visits. Investors place a value on this non-financial measure because it represents management’s ability to alter the company’s strategic direction. A large number of visits, for example, may give the company the ability to undertake new initiatives.

![Figure 2: Relationship between enterprise value and total visits, controlling for the effect of gross profits](image-url)
such as the development of an additional product line. Using its proprietary methodology, Ernst & Young has demonstrated that up to 50% of an Internet company’s value can be linked to real options. **Creating competitive advantage** Understanding the drivers of enterprise value can create competitive advantages for both pure-play e-commerce companies and bricks-and-mortar companies investing in e-commerce initiatives. First, insight into these drivers enables a company to align employees’ performance with the creation of shareholder value. Employees can be rewarded for achieving performance goals that are directly linked to measures that drive enterprise value.

The results of our study can also help companies communicate more effectively with the investor community. Management can determine the value drivers on which it has performed well and emphasize those results in its communications to investors. Finally, management can more accurately evaluate alternative e-commerce investments. The common practice of relying on a single multiple (or the wrong multiple!) provides less accurate information about the value of the investment than the approach presented here. By the same token, management can use this analysis to inform its growth strategy — in particular, by evaluating how much an investment or an acquisition would improve the company’s performance on the measures that truly matter to investors.
Mobile Commerce: Putting Integration in the Consumer’s Hands

Faster than e-commerce, say hello to m-commerce.

By John Distefano, Americas Services Line Leader, Mobile Commerce, Cap Gemini Ernst & Young

With the emergence of multi-channel retailing have come new approaches to online-on-land integration. Lids, a specialty hat retailer, offers in-store online shopping through intelligent kiosks. Other prominent retailers have tried “e-zones” within their retail stores in an attempt to provide parallel shopping alternatives. Major companies such as Gap and Circuit City integrate online shopping with traditional store purchasing by combining online with in-store pickup and return options. Still, the consumer views these channels as largely separate.

One promising solution is mobile commerce, which brings online shopping capability to any place at any time through wireless communication and mobile devices. Mobile hand-held devices such as cell phones, personal digital assistants (PDAs), and pocket PCs can be used to bring online shopping to the point of purchase. Time-pressed shoppers can get the convenience and versatility of online shopping with the hands-on reality of the in-store experience, simultaneously. Consider the following scenario:

Susan Steven’s teenage son is a discerning music fan. The stereo she plans to buy for his graduation must be rich in features and power. But because she will likely spend hundreds of dollars, she also wants to be price conscious. As she strolls down the aisle of her local Jumbo-Tronics store, Susan spots a suspect. Good looks, good sound, and good price. She scans the stereo’s UPC sticker with her personal shopping assistant (PSA) and instantly receives product information and a list of competitive products. She sees that the unit she is interested in has an e-note attached which signals more information. She clicks on the e-note and is told that the same unit is available just down the street at Buy City Electronics. She is also notified that if she purchases from Buy City, her family will be automatically eligible for their preferred CD buyers plan. “Not bad, but is this really the best deal?” she wonders. Another click on the e-note and she is reading the latest product review information from Consumers News, which confirms this unit is rated highest among its peers in this category. Now she’s convinced. As she heads to the exit to drive down the street to Buy City, she swipes her credit card through her PSA, and approves the purchase by entering her PIN and speaking a special voice password. She receives a confirmation number and proceeds directly to the customer pick-up counter at Buy City, confident that she made the right choice.
Mobility allows new ways for the retailer to weave itself more seamlessly into the daily life of consumers, whether they are riding home from work, rushing to a kid’s ball game or sitting in a movie.

Mobile commerce empowers the consumer

With mobile commerce, promotions, electronic coupons, comparison prices on favorite brands, and product information are delivered in real-time to consumers, wherever and whenever they need it. Aligning with this concept of mobility is a very compelling proposition to retailers. Companies are more eager than ever to reach consumers, and the explosive growth in mobile devices and usage presents unprecedented potential. Over the next few years, Internet access will increasingly become a wireless phenomenon, with analysts projecting that by 2003 we will approach one billion mobile Internet users worldwide compared with only 525 million wired users.

What are the opportunities?

The ultimate goal of retailers is to get shoppers to buy. Mobility allows new ways for the retailer to weave itself more seamlessly into the daily life of consumers, whether they are riding home from work, rushing to a kid’s ball game or sitting at the movie theater. Online shopping is limited in that most consumers may spend only a few hours a week at their home computers, and even then it’s a conscious and extra step to use it. Shoppers are, however, nearly inseparable from their cell phones and personal assistants — where they go, so goes their mobile lifeline. Retailers have an opportunity to invent a new class of service that leverages consumer and product information and applications specifically designed for mobile use. With mobile commerce, retailers can provide an endless number of “virtual end-caps;” each one aimed at a specific consumer segment or individual shopper. Retailers can instantaneously adjust in-store promotions not only based upon what is selling, but who is buying it. Leveraging the wireless and interactive nature of mobile commerce, retailers can establish a personalized shopping channel with the consumer, while a shopper in the next aisle experiences an entirely different set of product promotions and pricing options.

Where will the mobile wave take us, and how fast? To get a better idea, we can look to regions where wireless communication is most advanced. The Nordic counties, for example, are at the vanguard of mobile Internet and mobile commerce adoption. The penetration of hand-held Internet devices is one of the highest in the world, and vendors of infrastructure equipment, mobile devices, and network operators have all invested heavily in R&D to push the market into mobility. In Sweden, more than 60% of the population is equipped for mobile commerce. To gain a better sense of the thinking shaping the mobile trend, Cap Gemini Ernst & Young conducted a mobile commerce survey in September 2000 with representatives from 90 of the largest companies in Sweden. The interviewees were mostly business development executives, CEOs, and marketing directors.

Results from the survey showed that intentions and tactics varied by industry, but not surprisingly, the fundamental reason cited for adopting the new technology was to support business strategies, either growth or efficiency. Strategic intent within retail was mixed, with 23% of those surveyed...
Retailers should aggressively look to forge arrangements with the manufacturers to deliver innovative services through mobile technology.

viewing mobile commerce from an efficiency perspective and 27% from a growth perspective. What is more revealing, however, is that clearly one-half of the retailers surveyed did not view m-commerce as supportive of their business strategy. Compare this with most other industries where around 80% viewed m-commerce as being central to growth and efficiency strategies. Overall, the retail industry appeared to be the most unsure about the future of mobile solutions when compared with other industries.

Is the message “wait and see”? Not at all. Of the retail companies interviewed, 40% have a budget and the majority of these organizations plan to invest in mobility using today’s technology. Also, retailers in the survey expressed strong consensus regarding the aim for using m-commerce as a means to increase service through personalization. Early adopters in less mobile-mature industries such as retail can act as a transformer of the industry, gaining considerable competitive advantage.

At the same time, mobile commerce poses threats to retailers in the longer term. As consumers arm themselves at the point of purchase with more information about products they want to buy, shoppers may gain more leverage over retailers. Just like Ms. Stevens in the scenario described earlier, shoppers will be far more likely to compare prices, features, and service if they can do so with a few clicks rather than having to bounce between several stores. Retailers may also feel pressure from the supply side of their business. For consumer packaged goods manufacturers, mobile commerce allows a new, interactive tool to build relationships directly with consumers. Manufacturers have been very careful in the past not to promote channel conflicts, and have typically avoided broad-based strategies aimed at generating pure volume through online shopping. Instead, many have focused on offering customized or bundled products, or items not available in stores. But because mobile commerce provides the potential for entirely new ways to advertise, promote, and interact directly with the consumer, retailers should aggressively look to forge arrangements with the manufacturers to deliver innovative services through mobile technology. Those who don’t risk not only creating new competitive issues with their partners, but also missing an opportunity for a more personalized connection with its consumer base.

Making mobile commerce work
For mobile commerce to work, two critical components are necessary. First, wireless communication must be available to connect consumers with the services they want to access. Second, hand-held devices must offer more than the limited virtual “shelf space” that is visible on the tiny screen of a cell phone. For retailers and consumers alike, there is good news on both fronts, although the advancement and adoption of mobile technologies are phasing in at different paces throughout the world.

Regions such as Western Europe and Japan enjoy a stable, robust wireless system built on standard technologies. And users there will see tremendous jumps in capabilities as the third generation (3G) of wireless services spreads during the next
The necessary hardware and software to make mobile commerce practical is also rapidly advancing. During 2001, we will see mobile devices that rival the capacity and speeds of desktop systems of just a few years ago.

The mobile challenge
Like any so-called paradigm shift, mobile commerce will be met with a measure of skepticism. There may be some that think it will fade from the headlines before it affects any bottom lines. Don’t bet your business on that happening. Though some of the answers are still sketchy, it is clear that retailers who want to get one step closer to their customers and a step ahead of the competition should consider today how the mobile world will impact their business. Leading companies will need to open new collaborations and operating models with manufacturers. They should focus on creating personalized shopping by integrating the in-store experience with an online and real-time shopping dimension. Through mobility and interactive wireless communication, retailers will want to promote communities clustered around common themes such as product usage, demographics, or shopping preferences. And perhaps most important, they must do this while protecting consumers’ desire for privacy.
Meeting Customer Expectations
How do you connect with a consumer whose voice you can’t hear, whose facial expressions you can’t see, whose body language you can’t sense? Unlike physical stores, where face-to-face contact prompts instant response, the rendition of customer service online makes it hard to share shoppers’ delight in an unexpected find, their disgust over unavailable product, their frustration over a slow transaction, or their look of satisfaction upon completion of a successful shopping trip.

These are fundamental challenges that an e-tailer must overcome through its Web site design, which can only be responsive to consumers via technology, shown as dispassionate text on a screen, a pattern of site navigation, abandonment of a shopping cart, or other behavior that can be “tracked.”

Operational excellence is critical

Figuring out how to meet customer expectations online is not assuming that click-and-bricks operators have it down pat in the physical world. One thing it absolutely requires is operational excellence: having technology and logistics systems that will deliver beyond a customer’s expectation, and a mastery of integration between operations and the “front-end” relationship with the customer.

The success formula is simply this: if the customer-facing experience is good enough to inspire a purchase, operational excellence takes over to ensure secure payment systems, accurate and timely order fulfillment, easy returns, and ample service. It’s not surprising, then, that best practices don’t yet exist for the “humanization” of e-tailing, which would create a template for the delivery of what people want when they want it.

What do online shoppers want?

Ernst & Young research offers a road map to customer desires when e-shopping. The worldwide consensus among online shoppers and their expectations: a good selection of items, competitive prices, and convenience.

Top 3 reasons for shopping online

<table>
<thead>
<tr>
<th>Good selection</th>
<th>Competitive prices</th>
<th>Convenience</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1</td>
<td>#2</td>
<td>#1</td>
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<tr>
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</tbody>
</table>
Moreover, the vast majority of e-shoppers worldwide reported that they expect an online site to have about the same number of products as in stores and catalogs, and more than half also expect specials that aren’t available at retail. Unless consumer perceptions are changed, these findings mean that e-tail item selection must compare with what’s available in a chain’s physical stores or catalog. Identical pricing, along with some super-hot deals, must reward Internet shoppers’ initiative; prompt access to products and easy purchasing/payment processes must consistently attract e-shoppers.

In addition, when asked about price expectations across different shopping categories, consumers have definite ideas: 61% of global respondents expect online clothing purchases to cost less than similar items at retail stores, 78% expect online consumer electronics to cost less, 67% for toys, 47% for food and beverages, and 67% for health and beauty items. This says a lot about the psychology of e-shoppers and the profit implications for retailers. If multi-channel retailers must constantly reward e-shoppers for their efforts, they need to redesign their business model for the costs incurred in motivating customers to purchase online. What will happen to their visit frequency once retailers try to wean them off this habit? What might these people accept as a reasonable substitute? Are they so mercenary in their shopping that they’ll go elsewhere if a chain ends the practice? What does that say about loyalty to the store and the brands it sells?

On the issue of assortment overall, it’s obvious that offering anything less than a full complement of products online compromises the retail brand and annoys the established customer base.

Consumers expect purchases to cost less online than in stores

<table>
<thead>
<tr>
<th>Category</th>
<th>United States</th>
<th>Brazil</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Israel</th>
<th>Netherlands</th>
<th>South Africa</th>
<th>Spain</th>
<th>Switzerland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clothing</td>
<td>57%</td>
<td>64%</td>
<td>63%</td>
<td>58%</td>
<td>56%</td>
<td>62%</td>
<td>66%</td>
<td>73%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer Electronics</td>
<td>73%</td>
<td>61%</td>
<td>58%</td>
<td>67%</td>
<td>63%</td>
<td>72%</td>
<td>79%</td>
<td>79%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Toys</td>
<td>68%</td>
<td>72%</td>
<td>75%</td>
<td>65%</td>
<td>69%</td>
<td>70%</td>
<td>88%</td>
<td>89%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food &amp; Beverages</td>
<td>68%</td>
<td>63%</td>
<td>40%</td>
<td>36%</td>
<td>30%</td>
<td>29%</td>
<td>20%</td>
<td>25%</td>
<td>25%</td>
<td>14%</td>
</tr>
<tr>
<td>Health &amp; Beauty</td>
<td>62%</td>
<td>62%</td>
<td>60%</td>
<td>56%</td>
<td>67%</td>
<td>70%</td>
<td>83%</td>
<td>78%</td>
<td></td>
<td>66%</td>
</tr>
</tbody>
</table>

Offering anything less than a full complement of products online compromises the retail brand and annoys the established customer base.
have an opportunity to gain equity with shoppers is in the customization of products. As an example, ZDNet Australia reports that General Mills will soon start to test a Web site, www.mycereal.com, which enables visitors to create their own customized cereal, based on individual health needs and taste preferences.

More than one million ingredient combinations are possible, compared with about 250 varieties sold in grocery stores. Each serving will cost a U.S. dollar and be delivered to the consumer’s door within two to four business days of the order’s placement. Marc Belton, president of the company’s Big G cereal division, said in a prepared statement: “We look forward to gaining a better understanding of these consumers and servicing their specific needs. We also hope this will encourage consumers to keep and in some cases renew their interest in cereal.” This notion is certainly intriguing, not only for its ability to create an emotional connection between consumers and the company, but because it could elicit some wonderful new product ideas from consumers themselves.

**Personalization of sites and privacy issues**

Personalization of sites is a related notion, based on technological memory of how a visitor navigated the site previously, preferences indicated, service questions asked, and purchases made. This may make some customers feel special, but for millions of Web site visitors, privacy is the overriding concern: they want their history, behavior, and data protected. Click-and-mortar companies must tread carefully here and never reveal consumer information they collect, or they’ll risk being snared in a DoubleClick public relations fiasco. That company overstepped boundaries on consumer privacy when it stated its plans to merge anonymous customer information with the records of an off-line direct marketer, which would have resulted in businesses being able to target offers to individuals. E-tailers can best ease their users’ experience by understanding how people typically navigate and prefer to use Web sites. The best e-commerce sites should seem nearly intuitive, so users can be like drivers traveling down familiar roads with green lights all the way.

E-shoppers navigate sites in four different ways, explains Howard Tiersky, principal and executive creative director, DareStep, a division of Cap Gemini Ernst & Young: they search for specific content or function; they submit a search to a server, which gives them matches to choose from; they use links; and they make use of personalization features.

The first form of personalization lets visitors self-select into user groups, say, a separate home page for travel agents at the Carnival Cruise site. Second is memory based on a user’s previous pattern. Mapquest, for instance, recalls the last five addresses a person entered as a starting point for requested directions.

E-tailers can achieve these types of personalization by either architecting information or using client-side cookies. Other...
ways are storing information provided by customers, such as shipping addresses, or tracking previous buying and site navigation patterns, Tiersky adds.

Personalization is perhaps the most emotional aspect of a user’s Web experience, because through technology the site “remembers” preferences and behaviors and creates pleasant virtual encounters.

**Government regulations and privacy protections**

Privacy matters are reaching official heights, with the announcement that Canada will enact a law in January 2001 that offers its citizens sweeping protections. The report in *Computerworld* implies the possibility of “legal obligations and data management problems for potentially thousands of businesses that exchange data with firms and subsidiaries in Canada, the U.S.’s largest trading partner.”

Canada’s Personal Information Protection and Electronic Documents Act requires companies to obtain customer consent before sharing data. While the law initially applies to airlines, banks, and other regulated businesses in that country, by 2004 it will affect virtually every Canadian business, including retailers.

American companies that exchange “personally identifiable information with Canadian firms and subsidiaries” may need a contract that commits them to following Canada’s law, adds the report. That’s only one aspect of privacy. Another “e-tail chiller” has been the need for consumers to trust in a secure online payments system. People’s concerns about using credit cards online are akin to consumers’ reaction when automated teller machines first arrived. By now, encryption and certifiers such as Trust-E have brought ample security to domestic bricks-and-clicks — although secure transactions remain a problem internationally, particularly in Brazil.

**Shopping cart abandonment rates are still high**

How bad is the problem? Three out of four e-shoppers worldwide tell Ernst & Young they’ve “placed products in an online shopping cart, but did not actually complete the purchase during the past year.”

### Shopping carts are frequently abandoned

|                | U.K. | U.S. | Non-U.S. | Australia | Brazil | Canada | France | Germany | Israel | Netherlands | South Africa | Switzerland | U.S. | Non-U.S. |
|----------------|------|------|----------|-----------|--------|--------|--------|--------|--------|-----------|-------------|-------------|--------|
|原因             |      |      |          |           |        |        |        |        |        |           |             |             |        |         |
|Shipping cost too high | 24% | 23% | 28% | 28% | 20% | 20% | 17% | 22% | 20% | 24% | 23% | 22% | 24% | 26% |
|Price check      | 18% | 17% | 19% | 23% | 19% | 14% | 12% | 14% | 12% | 19% | 18% | 14% | 18% | 22% |
|Check out process was long/unclear | 25% | 28% | 17% | 26% | 18% | 12% | 22% | 24% | 17% | 20% | 23% | 18% | 18% | 22% |
|Price too high   | 23% | 25% | 21% | 22% | 21% | 16% | 17% | 20% | 16% | 23% | 22% | 18% | 19% | 23% |
|Changed mind     | 25% | 24% | 25% | 22% | 20% | 16% | 19% | 21% | 18% | 23% | 22% | 18% | 20% | 24% |

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**GLOBAL ONLINE RETAILING REPORT**

Placed products in shopping cart but did not complete the purchase:

REASONS
- Shipping cost too high
- Price check
- Check out process was long/unclear
- Price too high
- Changed mind
High shipping costs were the number-one reason, cited by 42% of consumers worldwide. Indeed, shipping costs are among the biggest factors discouraging people from buying online: “high shipping costs” came in at number-one, named by 46% of respondents. Moreover, some 53% of respondents said lower shipping costs were the number-one improvement they would like to see in online shopping, and 55% said free shipping would get them to visit a site more often.

However, companies routinely charge for shipping. And defying logic, many e-tailers increase the shipping cost based upon the value of the purchase, in effect penalizing people for buying more. A fairer and more reasonable approach would be to assess the expense by cube and weight, as some computer vendors do. The most seamless method would be to figure shipping and handling into the price of the merchandise so it is transparent to consumers and can’t infuriate them.

Still another next hurdle for an e-tailer to overcome is the issue of the importance of “personal sizing,” where consumers lack confidence in achieving an excellent fit on an item they haven’t tried on. Some 44% of respondents said this, with incidence of mention ranging from 31% in Spain to 60% in Brazil.

For all the complaints consumers voice in every country and every culture about e-commerce, remember that it’s their nature to complain. They complain loudly and consistently, but at the same time have bought more online in 2000 than in 1999, and say they expect to buy more every year into the foreseeable future. Consumers voice displeasure every day about their experiences in physical stores, but they still keep going back to fulfill their needs.
The best e-tailers strike a better balance between the content of a sale and its context, the way in which the transaction is carried out, and how well it fits into the nature of consumers' lives.
do what they want — when they want it — in the way they want it. And that’s why the value proposition of e-tailing is tailor-made for them.

But the industry’s current track record suggests that many consumers are not agreeing that e-tailers are meeting their needs. In the face of a disappointing 1999 holiday season, e-tailers spent most of 2000 trying to make up lost ground. Unfortunately, with average industry conversion rates less one-third the average of off-line retailers, customers are still not buying enough on the Net to allow many e-tailers to become profitable.

According to the latest data from the University of Michigan’s Business School’s American Customer Satisfaction Index (released late November 2000), e-tailers, on average, score slightly higher than their off-line counterparts in customer satisfaction, with an average score of 78 versus the off-line average of 73. Even so, the scores of e-tailers are buoyed by the success of Amazon.com (whose average is 84) and many of them (including Buy.com, Egghead.com and 1-800-Flowers) fall way behind the stars of retail in this survey, including Publix (84) and Costco (79).

As the lead professor in the study writes, e-tailers are now “attempting to increase sales per customer...and gain more repeat business. In order to succeed, it is critical to provide very high quality of service including reliability, dependability, and trust.” Already, the average score of portals (63) is way below the average of retail (73), held down by the disappointing showing of AOL.*

Why do e-tailers struggle, despite the attractiveness of their value proposition? Today’s customer is aware and demanding; she knows and is willing to exercise her options. She wants something more from every company. As a result, the e-tail value proposition must expand and deepen along with her changing opinions.

Consider the way our interview subjects describe the ideal online approach in terms of the five classic attributes of any transaction: price, product, service, experience, and access. These consumers tell us repeatedly, that while they judge all retailers based on these attributes, their meaning is changing and many retailers don’t understand that:

- **Product**, in terms of online sales, means a site is never out of stock on the widest assortment of top-quality products. Eddie Bauer’s successful online approach, offers a full range of products, as well as a virtual dressing room that gives consumers the opportunity to test various combinations.

- **Service** means credit card purchases are secure and merchandise can be returned quickly, without hassles. At the high end, it also means a high level of individual customization. Many e-tailers fall down on service, and are changing. Ahold, the global supermarketer giant, will emphasize service in on-line grocery shopping in its new acquisition, Peapod. It will downplay the Peapod brand and concern.

MEETING CUSTOMER EXPECTATIONS

For online consumers, a good experience means being treated with the respect necessary to form the basis for a long-lasting relationship.

In the case of online sales, what you are looking for, and you can rely on the e-tailer when you are in a bind. One consumer, Margaret, tells us that access means "I can see that I've got to pay for shipping right away, I can find what I want, and that I can expect to get the product on time. Also, I expect to be able to download quickly, even on my phone line, and to navigate the site without any problems." Tesco dominates in the UK market largely because it provides customers access in every sense of the word, including access to a greater breadth of products. (Tesco now is one of the largest sellers of children's clothing in Britain.) The importance of access can also be seen in the company's development of an online Web-based grocery service that is the envy of other retailers. With this service, customers order merchandise, and e-shoppers immediately pick the items, getting them to the customers quickly.

Price, in terms of online sales, means you "feel you are getting the lowest price available for leading brands," a seemingly classic interpretation of price. But focus group interviews tell us that this is actually code for a crossover concern from service. The key is in the words "leading brands." For consumers leading brands is an implied warranty for the quality of the product because they don't want to have to enter the scary and confusing world of online returns. They seek leading brands, hoping that they will never, ever, have to attempt to return anything. This is a big opportunity in disguise for a retailer that
allows online sales to be returned at physical stores, and it presents a challenge for online pure plays. Digging deeper into price online reveals two types of consumers, price conscious and price unconscious. The online world has two broad constituents, those with the time and inclination to troll for the best deal, and those who are in a hurry and will pay anything within reason for good products delivered on time and in one piece by an online retailer that makes it easy and fast for them. The trick is in understanding which one type of customer you are dealing with.

We have found three underlying causes for this consumer attitude. The first is the Information Age, whose good aspects, symbolized by information accessibility, consumer self-service, and increased productivity, are balanced by the bad — information overload, stress, and cynicism. The second is the gradual but pervasive breakdown of social infrastructure: school, church, family structure, and government. This combines with an increasing ability of the media to capture and deliver ever-more-graphic and granular images in nearly real time to create consumers who are questioning the validity of the society in which they live, and their role in it.

The third is the simple pressure of time. Everywhere we look we find a common thread: people struggle to find the time to be a great employee, parent, child, neighbor, philanthropist, and spouse. So, despite unprecedented economic growth, consumers are haunted by three relatively new but exceptionally important needs:

- The desire for ratification and reinforcement of their personal value set. They want to feel like someone cares.
- Help in surviving psychologically and emotionally.
- Clarity and simplification in order to feel satisfied with their choices.

The impact of these trends and the development of the new set of needs means the context in which a good or service is offered has become as important as the actual content of a transaction. Human values have pulled even with, or even eclipsed, product or service value when consumers evaluate a commercial offering. For e-tailers searching for the profitable top-line growth necessary to survive and attract capital, this means that their online offerings must include a sense of the values consumers want.

For many companies, responding to consumer values is a foreign notion. Most focus on offering the best products possible — at low enough prices, and support their operations with customer service representatives and efficient fulfillment. But we found that companies are focusing too much of their finite resources on being excellent at every process they can, and not enough on the market. They have been pursuing a myth — that they could be excellent in all aspects of their operations, and that this would drive top-line growth. In truth, companies that try to be excellent...
in every way are doomed either to fail, or to leave significant money on the table.

The Consumer Relevancy approach was developed to help e-tailers formulate strategies and plans for operational improvements based on the development of solid external insights. Using these insights as a foundation, companies can make plans that will work.

How does Consumer Relevancy work?

The mission of Consumer Relevancy is to drive top-line growth and profitability by aligning a company’s commercial offerings with unarticulated and unmet human values.

Companies using CR as a basis for strategy can consciously do what many successful e-tailers, like Amazon, Eddie Bauer, Gateway, and Tesco intuitively do — define consumer value in consumers’ terms and make the strategic trade-offs necessary to increase profitability and customer satisfaction.

Consumer Relevancy starts with the five attributes, price, product, experience, service, and access, and uses them as a framework to prescribe corporate action. That framework helps a company determine the right direction for any strategic change or operational improvement — making certain it will lead to competitive differentiation and growth.

To win back customers — and bring in new ones — relevancy requires that a company dominates on one of the five attributes (a score of “5”), meaning that the company sets the standard on this attribute; differentiates on a second (a score of “4”), meaning the consumers prefer its products or services; and be at industry par (a score of “3”), meeting basic expectations, on the remaining three.

It is important to note that anything less than a 3 on any attribute is not sustainable and will cause brand damage, as customers will gradually reject the value proposition. This is truly the secret to the dizzying decline in the fortunes of dot-coms like Drugstore and Priceline. They did not come up to customer expectations in order fulfillment and consistency of operation. Conversely, domination or differentiation on more than one attribute is excessive, resulting in companies wasting money.

Of course, all of the definitions of what a “5,” or “4,” or “3” is change as consumer expectations change. Failing to keep up with expectations and perform at that level will cause brand damage and erode long-term customer retention.
In the end, Consumer Relevancy demonstrates that winning e-tailers follow five steps to success. They must:

- Truly differentiate the way they sell products and services.
- Understand the market’s value perception.
- Plug into unforeseen market forces.
- Demonstrate operational consistency.
- Create organic operations.

Listen to the market — and then act with Consumer Relevancy

Around the world, we’ve talked to customers just like Margaret, a 38-year old mother of four. When we asked about her experience in the world of e-tailing, she said: “I shop online for one reason only — to get the best selection, at the lowest prices. But when I run into any kind of hassle, it’s so easy to switch. There are millions of sites selling everything. So, if I get angry, I just click off. Come to think of it, I click off more than I do on.”

We were startled by the strength of her reaction — and by those of so many of the other consumers we interviewed, once they were allowed to talk about anything they wanted to. They told us the real reasons why so many of them have been leaving sites so quickly, and failing to come back. Companies are simply not meeting their needs.

When we talk about Consumer Relevancy, we ask senior executives the following questions:

- Do you know why your customers behave the way they do?
- What is the one thing you’re not doing that most of your customers want you to do?
- What is the one thing that will bring new customers in?
- What are the two things you must not change?

The senior executives of Gateway, Amazon, Ahold, Tesco, and Eddie Bauer can answer these questions. If you can’t, it’s time for Consumer Relevancy.
What’s most important in security today is a company’s ability to systematically ensure the integrity and security of personally identifiable information—like customers’ credit card numbers—that they collect and store on the Web.

Even as consumers come to embrace online shopping as an everyday part of their lives, they remain concerned about the security of their credit card transactions. Worldwide, credit card security concern is the fourth-biggest factor discouraging online buying, and “guaranteed security” ranks third as the improvement consumers would most like to see on the Internet. Clearly, companies must take this issue very seriously. Especially for bricks-and-mortar companies coming online, proactive security practices are vital to protecting brand integrity and ensuring the consumer trust that has been established on land.

What’s most important in security today is a company’s ability to systematically ensure the integrity and security of personally identifiable information—like customers’ credit card numbers—that they collect and store on the Web. But with the world of technology undergoing continuous, rapid change, it’s not enough merely to employ traditional, point-in-time solutions, which are designed simply to give a company a snapshot of its current security weaknesses, and temporarily employ the latest measures to stave off hacker attacks. The larger challenge is to develop a proactive, knowledge-based security posture that:

- Identifies your threats and vulnerabilities
- Manages your risks
- Protects your critical assets and systems
- Detects intrusions and responds to incidents
- Elevates security awareness company-wide

You need to develop and implement a best-practices security program that is perpetual, proactive, time-efficient, cost-effective, and possesses integrity (i.e., preserves the accuracy of information). Your main task is to determine which threats are most important (and must be addressed first), which are of medium importance, and which ones are unimportant. In most cases, however, the data and the risk to the data—not the technology application—should determine the level of security you provide. So, to classify the risk sensitivity of your data, you should create a risk profile of your unique technology environment and data by weighing the importance of the following factors:

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**Better Secure Than Sorry**

Establishing a successful retail presence online without putting their business’s security on the line is the challenge facing today’s retailers.

By Jerry R. DeVault, National Leader of Innovative Assurance Solutions, Assurance & Advisory Business Services Practice, Ernst & Young, and Anthony Spinelli, Vice President, Channel Integration and Operations, eSecurityOnline.com
You need a knowledge-based content provider that not only feeds you knowledge, but also informs you of threats, tests their impacts, and shows you how to eliminate the risks that make you vulnerable.

- Your business strategies
- The policies and procedures that support your business strategies
- The technologies that support your policies and procedures
- The importance of maintaining: 1) confidentiality (security); 2) integrity (accuracy); and 3) availability (accessibility) of your information/data
- The risk sensitivity level of the above three necessities
- The configuration you need to apply to achieve the necessary level of security

After you’ve prioritized your risk factors, it’s critical for you to find solutions in the marketplace that will augment your security posture at points where it may be weak. This has become a challenge due to competing resources. You want to apply a robust security strategy while overcoming an IT human resources shortage. You can integrate the latest security offerings into your environment by subscribing to a trusted knowledge-based solutions provider. The provider will give you information on the security vulnerabilities of the technologies your company uses. Now, armed with knowledge and tools, you’ll be able to design and put into action a security program that is perpetual, base-lined, monitored, verified and proactive, by taking the following steps:

- Perpetual — putting in place solutions (e.g., VPNs, firewalls, and encryption) that mitigate the risk exposures of your business.
- Base-lined — establishing security policies and awareness programs that educate your user community on security concerns.
- Monitored — continuously monitoring your internal network and external firewall, including the area between them — know as the “demilitarized zone” (DMZ) — to prevent system vulnerabilities and attacks on your infrastructure. Do this by reviewing IDS or firewall logs.
- Verified — hiring corporate security experts, independent consultants, and internal auditors to review your security posture, as well as engaging external auditors to examine and verify your security assertions so you can communicate them to your stakeholders.
- Proactive — employing knowledge-based solutions that deliver the latest validated security vulnerabilities or configurations and are customized to your environment. This will enable you to provide effective, efficient solutions to new threats.

Traditional approaches to security, such as hiring consultants to perform attack and penetration attempts, are also important. But you must go further. You need a knowledge-based content provider that not only feeds you knowledge, but also informs you of threats, tests their impacts, and shows you how to eliminate the risks that make you vulnerable.

Indeed, your online operations are like a sports team: they need a strong offense —
Security is one thing. Proof of security is another. You not only need to create and maintain a protected environment, but you should prove it through independent “audits.” You should not only address your customers’ primary concerns, such as credit card security — and thereby live up to their trust — but as a leading company you should also provide assurance to your customers by making available independent verification reports. By proving you’re doing what you’re saying, you’ll create a competitive advantage, gain repeat customers, and earn trust. Because whether they’re shopping in buildings or stores, customers buy from you only if they trust your brand. Indeed, security is not just about protecting data and knowledge, but also creating a feeling of confidence for the consumer who accesses or provides information, and completes transactions, on your Web site.

Risk is quantifiable. You can systematically pinpoint and mitigate online security dangers to create a secure environment that not only is critical to conduct e-business, but will free you to transform your organization into a multi-channel retailer powerhouse.

Meeting Customer Expectations

a framework that enables you to develop and improve information protection within your business operations. That’s why you need to establish an Enterprise Security Architecture (ESA) — a framework composed of people, processes and technical controls that mitigate risk but do not increase costs and add burdens to your day-to-day operations. With an ESA, you’ll accomplish the following critical goals by undertaking corresponding measures:

- **Safeguard consumer trust and confidence** by providing the mechanisms that guard the privacy and confidentiality of your corporate and customer information.
- **Minimize corporate risk** by establishing security baselines throughout the corporation that continually improve the quality of your security engineering and decrease the amount of threat and risk to your company.
- **Drive down security costs** by building a technical, procedural, and organizational foundation to deter or rapidly resolve security breaches and incidents.
- **Maintain objectivity** by providing the mechanisms to measure and report on the effectiveness of the corporate security investment.
- **Accelerate speed to market** by enabling a secure technical infrastructure that can be leveraged to take advantage of distinct e-commerce initiatives in the marketplace.
Innovative ideas open up possibilities

It's a whole New Economy with a whole new set of rules. To open the door to a world of new opportunities, you have to play by these rules. With our retail and consumer products industry experience, we have the tools and fresh financial perspective to help you increase value in your business and enable you to make decisions more clearly and confidently than ever. So come on in.
If it's part of a focused strategy, your people embrace it,
your customers buy it and your technology supports it...

One idea can make your future brighter.

From innovation to execution, our people deliver.
Globalization
For luxury brands such as Gucci and Prada, fast food chains such as McDonald’s and Burger King, or retailers such as Nike or The Gap, going global is already a matter of business survival. Amazon.com, which is one of the favorite sites of consumers in 11 out of 12 countries researched in our report, has proven the power of the Internet for global selling.

The lure of expanding a customer base with easy access and communication via the Internet is too great an opportunity for any serious company to ignore. Global expansion on the Internet promises expanded customer reach and greater revenues and profits for retailers. But achieving success requires more than mere Internet presence and brand recognition by consumers. Retailers must assume appropriate roles in cyberspace, adopt relevant marketing strategies, establish sound business procedures, and go local in every dimension of their business.

The global Internet sales potential is great

The majority (58%) of all consumers surveyed outside of the U.S. report that they have purchased from an online business located in a country other than their own. Even more significant is that more than 70% of respondents from Canada, Israel, the Netherlands, and Switzerland have purchased from an online retailer in a foreign country. In addition, at least one of the companies interviewed in each of the 12 countries interviewed by Ernst & Young report that they sell to international customers via their online site.

Why are consumers shopping globally? In all countries, the top reason is because a product was not available from a company in their own country. The fact that they could get the product for less was the other significant reason given for purchasing outside of a native land, although the degree of significance varied greatly by country, from 5% in Germany to 50% in the U.K.

### Global purchasing

<table>
<thead>
<tr>
<th>Country</th>
<th>Purchase online from a company in a foreign country</th>
<th>Product not available in my country</th>
<th>Product cheaper</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>12%</td>
<td>54%</td>
<td>25%</td>
</tr>
<tr>
<td>Non-U.S.</td>
<td>38%</td>
<td>69%</td>
<td>30%</td>
</tr>
<tr>
<td>Australia</td>
<td>44%</td>
<td>60%</td>
<td>36%</td>
</tr>
<tr>
<td>Brazil</td>
<td>45%</td>
<td>58%</td>
<td>42%</td>
</tr>
<tr>
<td>Canada</td>
<td>52%</td>
<td>72%</td>
<td>53%</td>
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<tr>
<td>France</td>
<td>53%</td>
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</tr>
<tr>
<td>Germany</td>
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<td>72%</td>
<td>53%</td>
</tr>
<tr>
<td>Israel</td>
<td>42%</td>
<td>67%</td>
<td>49%</td>
</tr>
<tr>
<td>Netherlands</td>
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<td>67%</td>
<td>52%</td>
</tr>
<tr>
<td>South Africa</td>
<td>46%</td>
<td>71%</td>
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</tr>
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<td>64%</td>
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<tr>
<td>Switzerland</td>
<td>51%</td>
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<td>51%</td>
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</table>

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Clearly, customers have already discovered how easy it is to shop globally. When you consider the fact that consumers will continue to shop this way — and plan to spend more, from an increasing number of product categories online — even as they become more sophisticated in their online shopping behaviors, the implications of how to run a global online business successfully are great. Companies must consider the global market, and they must consider the importance of global brand recognition.

Local issues are complex
To “act locally” is no different online than on land. Companies must understand consumer preferences, values, and shopping habits, as well as cultural conventions and regulations. Respecting the language of each target market is as critical to success as understanding what motivates consumers to buy online in their particular countries.

But participation in the global Internet economy involves much more than a simple Web site translation and having a recognizable brand name. It requires a sound business infrastructure, including knowledge of local business practices and government laws, as well as internal operations that efficiently manage the localization of content. In addition, managing and maintaining a consistent global pricing strategy on land and online is essential for brand consistency and maintaining customer satisfaction and relationships.
Keeping Web content up-to-date is still a challenge for many companies that sell only in their own country. Multi-channel retailers are struggling to achieve consistency between their online and on-land operations. Synchronizing content, as well as pricing across borders, presents a whole new management challenge. The ability for buyers to obtain instant competitive pricing on the Web increases the competitive pressure.

In many countries, transnational data flows are controlled by government regulation, which may involve tariff structures, data protection and security, or laws that prohibit cross-national data. French laws, for example, prohibit the transfer of employee files across national borders, and such rules apply to other sensitive data regarding customer purchases and related information. Other laws, including even at provincial levels, control what can and cannot be said, done, or transferred in several countries, including Brazil, Germany, India, and Sweden. A bill passed by the European Union that will go into effect in March 2001 will require online stores to abide by the laws of all EU member states.

The Internet is a global medium; its foremost role in both domestic and international marketing is the same — the delivery and collection of timely data, which includes information about products, services, and transactions. But to benefit from this data about customer’s behaviors and preferences, a company’s infrastructure must have the capabilities to use it. The Internet is already reaching international shoppers. The challenge is to make the interaction process easy, applicable, legal, and profitable.
In general, the more a company shifts business risks or functional activities to low-tax jurisdictions, the greater the savings it may realize.

Global online retailing presents numerous business challenges, from merchandise return issues, to logistical concerns, to marketing to local tastes and customs. Moreover, as retailers continue to expand online operations into multiple countries, local tax law issues must be addressed. Typically, this is considered an additional administrative burden and expense. For the tax-savvy retailer, however, operating internationally could be an advantage and may actually present the opportunity to reduce overall tax expense and increase earnings per share. Although some taxes, such as import duties, may be unavoidable, addressing these tax concerns proactively can help to mitigate overall tax expenses.

Depending on the country in which it operates, a company can be inundated with a host of different taxes. However, taxpayers can gain a competitive advantage by paying special attention to the following areas of opportunity and concern.

Arbitraging various countries’ income tax rates
Global operations can actually provide an opportunity to reduce taxes by realizing online retailing income in low-tax, rather than high-tax, jurisdictions. Income may be earned in low-tax jurisdictions in various ways. For example, a retailer can set up a separate subsidiary in a low-tax jurisdiction to operate the online retail business. If properly implemented, this subsidiary will capture profits in a low-tax jurisdiction, thereby reducing the company’s overall tax expense.

Multi-channel retailers can also take advantage of this strategy if profits earned by a low-tax subsidiary includes income relating to the retailer’s brick-and-mortar operation. For example, a trading company subsidiary could purchase and re-sell merchandise to a retailer’s stores, thereby capturing profits in the low-tax jurisdiction. Furthermore, the Internet allows geographically neutral activities, such as purchasing and/or sales transaction processing, to be hosted by a separate company that can capture service fees in the low-tax jurisdiction and, accordingly, reduce taxable income in other high-tax jurisdictions in which the business operates. Income from intangibles such as domain name, software capabilities, customer and supplier lists, distribution rights, trademarks, and trade names should also be examined since it may be possible to capture royalty fees in a low-tax jurisdiction. In general, the more
a company shifts business risks or functional activities to low-tax jurisdictions, the greater the savings it may realize.

Implementing such strategies can be very complex, however. Retailers will need to consider the nuances of many tax issues specific to a company’s operations, such as taxable nexus, income tax treaties, transfer pricing, the financial statement effects, other taxes like VAT and duties, sourcing of activities, and anti-deferral provisions.

Taxes on imports
Generally, regardless of the ultimate distribution channel, if products cross borders there will undoubtedly be import duty issues, an area of taxation providing an abundance of opportunities for creative tax planning. Furthermore, depending on various factors, such as the classification of the item imported, whether the item is subject to quota restrictions, and country of origin, duty rates can be very high and tax planning can provide significant savings.

A few examples of duty-savings strategies include: “tariff reengineering” (i.e., reclassifying a product to a lower-duty classification); creating a new classification for new products; reducing a product’s valuation or “dutiable” value; importing goods from a country that has preferential treatment under a treaty; and capitalizing on the advantages of a foreign trade zone or customs bonded warehouse.

The following discusses, in greater detail, two of the aforementioned duty-savings strategies: tariff reengineering and reducing a product’s dutiable value.

**Tariff reengineering**
“Tariff reengineering” is the act of reclassifying a product to a lower-duty classification. Binding classification rulings are generally obtained from customs agencies to obtain concurrence and minimize risk. Reclassifying products can result in lower duties and can provide other benefits such as avoiding quota restrictions. Following are some examples of creative tariff reengineering situations:

- A woman’s bodysuit, which had a duty rate of 33%, was reclassified to women’s underwear, which had a duty rate of 16%. Thus, for every $1 million of imports, the savings is equal to $170,000.
- A tent used for camping was reclassified from the general tent category (9.4% duty rate) to a backpacking tents (2.3% duty rate) category and, in some instances, to a toy tents (duty-free). Also, the general tent category is subject to quota restrictions, whereas the new categories have no quota restrictions. By combining camera cases (duty rate of 20%) and cameras (duty rate of 0.6%) as a set, a company was allowed to apply the lower camera duty rate (i.e., 0.6%) to the camera cases.

**Reducing a product’s dutiable value**
As mentioned above, reducing a product’s valuation or dutiable value is a common duty-saving strategy. Another planning strategy involves identifying costs that can be unbundled or carved out of an imported good’s dutiable value. An imported product’s dutiable value is often overstated by including non-dutiable costs, consequently
Globalization

Customs agencies can assess severe penalties for failure to meet requirements. In certain circumstances, penalties may be as high as eight times the amount of underpaid duties.

Update on consumption taxes

Depending on the country, global online retailers may have to face VAT issues when selling abroad. VAT is imposed on final consumers and applies wherever consumption takes place. VAT rates can be as high as 25%, but more important, the administration of VAT can be a nightmare for many retailers.

The European Union issued guidance earlier this year on certain e-commerce transactions. However, the proposal has no effect on sales of physical goods. Therefore, with respect to retailers, many VAT questions and problems remain unanswered. Currently, many countries' VAT systems do not specifically address many of the online retail issues, such as refunds associated with returned merchandise, taxable nexus issues, and overly burdensome VAT administration. Until these issues are resolved and/or additional guidance is provided, VAT will remain a huge headache for retailers.

Whether you are selling online in many countries or just a handful, valuable tax-savings opportunities are available with proper planning. Moreover, incorporating e-commerce into your strategic business initiatives will undoubtedly change your supply chain. These changes present significant tax opportunities; but to capitalize on the potential tax benefits, it is imperative that you integrate your business plans with your tax planning.

Senior Managers Hanspeter Kurz, Switzerland, and Darryl Yee, United States, also contributed to this article.
Ask most Australian retailers what is at the root of their e-business strategy and the likely answer will come in the form of one simple word: growth. And it’s no wonder. A significant portion of the Australian population is ready, willing, and able to shop online. More than 50% of Australian households have PCs, with 39% having Internet access. Indeed, more than 50% of Australians over 14 years of age have accessed the Internet, a fact that bodes well for Australian retailers as they begin to accelerate the speed of their e-business initiatives.

The extent of online strategies varies considerably among Australian brick-and-mortar companies. Some of Australia’s largest retailers, such as Coles Myer and David Jones, have embraced the Internet as an important alternative distribution channel. The scale on which Coles Myer launched its online presence reflects the company’s belief in the medium, as well as its response to the growing consumer demand and pressures from the stock market.

The state of a company’s e-strategy has become an important factor in the eyes of the Australian investment community. However, the investment community’s approach to B2C e-commerce does seem sensible. On the other, investors have become less tolerant of under-performing B2C businesses and far more interested in return on investment and profitability. The investment community has also begun to focus closely on the cash-burn rate of pure-play Web retailers.

Start-up etailers have gained a significant presence in the market. Operators such as Travel.com.au, Wineplanet.com.au, and Greengrocer.com.au have appeared on the scene and have stood the test of time, so far. Some of these pure-plays have learned the value of working in concert with well-established traditional retailers. For example,
Wishlist, an Australian-based online gift store, has developed high-profile alliances with brick-and-mortar retailers such as Country Road Limited, a clothing retailer with stores in Australia, New Zealand, and the U.S., and BP Australia, a gas/petrol station with convenience stores attached.

Growth drivers run the gamut
Driving e-business growth are a number of additional factors that go beyond consumer and investor demand. For one thing, many retailers believe the online channel represents an opportunity to expand their presence outside Australia. And for some operators, it is likely that e-business represents a defensive strategy, since much of Australians’ online buying is being done on U.S.-based sites. But with the fall in the Australian dollar, this is now much more costly.

A largely positive climate — characterized by governmental support, a favorable regulatory environment, an increasingly sophisticated telecommunications business, and a well-established infrastructure — should help nurture the nascent Australian e-tailing market. However, this positive environment is impacted by a complex, punitive tax regime with a new goods-and-services tax and potentially hostile investor sentiment.

At the same time, there remain a number of hurdles that businesses must surmount in order to succeed at the e-tailing game. Consumers continue to be concerned about credit card security, despite their increasing interest in online shopping. In an effort to reassure consumers, e-tailers are addressing security concerns in a variety of ways. Most will emphasize their use of an Internet security firm, such as VeriSign, by prominently displaying the security company’s logo on their site. Some automatically insure transactions up to a certain amount, say, $2,000 (Australian dollars). And others allow online buyers to phone or fax in their credit card information rather than require that it be given over the Internet.

Traditional retailers face unique issues, including effectively translating the brand online. The marketing manager for leading Australian retailer David Jones notes that having a leading retail brand “is a great corporate asset, but the challenge is in creating a seamless shopping experience for the customer between on and offline stores.”

The costs associated with Internet access and distribution in remote areas have proved to be a barrier to B2C e-commerce growth in some parts of the country. Fulfillment costs in the e-grocery segment, in particular, also remain a significant challenge. Other companies, including Hillier, cite technical limitations, particularly the speed of the Internet, as a key challenge.

Executing the e-strategy
Many of the country’s e-tailing models — whether pure-plays or traditional operators — focus on customization. Coles Myer, for instance, has launched a number of initiatives in terms of branding and product offerings that differ by region based on the company’s understanding of customer needs in that area. Smaller retailers engage in customization to varying degrees.
Although the companies interviewed offered the same products online and in-store, the merchandise mix offered by traditional Australian retailers on their sites tends to be less extensive than that offered in their physical stores. Some retailers simply offer information; others provide a limited range of products such as gift vouchers, gift baskets, and accessories, though Dymocks, a book retailer, has an integrated product offering: books offered online are available at the store, and books not available at the store can be ordered online.

Pricing online is fairly consistent with that in the stores, and most e-tailers charge for delivery. Online specials and discounts are most likely to exist in segments such as airline tickets. Simon Hillier, general manager, content and marketing at Australian-based Travel.com.au, points to the importance of being first to market with special offers. “Traditional travel agencies have to rely on newspapers and these offers get published days later,” he says.

Retailers’ marketing efforts include store signage that promotes the Web site, promotional brochures, delivery vehicles, and in-store Web access through terminals. Customer communications vehicles such as newsletters — both paper and e-mail versions — are also being used with increasing frequency. A handful of pure-plays, such as Dstore and Wishlist, have managed to build strong brand awareness through extensive spending on offline advertising campaigns. And some companies, such as Dymocks, have established affiliations with other e-businesses in an effort to drive customers to their site.

Customer loyalty initiatives vary among the major retailers and the smaller brands. Coles Myer has an extensive database of customer intelligence from its various loyalty efforts such as shareholder discount schemes and fly-buys. The company views this database as a significant strength and utilizes data mining to analyze the information and drive decision-making. Smaller retailers have different degrees of sophistication in their loyalty programs and level of customer understanding. Interestingly, while the majority of e-tailers stick to email reminders and simple loyalty programs to entice customers to return to the site, almost 50% of consumers say free shipping of products would encourage them to come back.

A variety of distribution models are in place. Many companies are utilizing Australia Post, the country’s postal service, which has promoted its ability to act as a delivery point for e-tailers. In addition, BP has undertaken an initiative to establish itself as a pick-up point for merchandise purchased from e-tailers (no doubt hoping consumers will also buy at the BP convenience store while picking up their online orders). Some retailers have begun using store pick-up models or are converting existing stores to distribution centers.
Australia: Wired
Consumers Take to the Net

As Australian consumers venture onto the Web, they’re buying more, but many still worry about credit card security and the inability to see and touch products.

Australian consumers have discovered the virtues of online buying and are growing more comfortable with the channel. Internet shopping has risen dramatically over the past year and will continue to grow in the coming year. Among Net users surveyed, 58% have purchased an item in the past 12 months and 82% expect to make an online purchase in the coming year. And close to eight out of 10 said they have increased the number of items purchased online, compared with the prior year. Only 2% have made fewer transactions. In addition, more than three-quarters of buyers have increased the value of their online spending.

Several issues are expected to impact the rate of e-commerce development, however. Concerns about the use of credit cards online — cited by 63% of respondents — leads the list of reasons why some consumers will not make online purchases. Most online buyers said they are aware of features such as browser encryption capability and digital certificates that point to online security. The benefit of promoting these features would be felt most with non-buyers who are fearful of online credit card transactions. Online security is not the only concern among Australian Web users. Almost as many (61%) said they will not buy over the Net because they prefer to see and touch products first. Other reasons include not having a credit card, a lack of
confidence in online merchants, and a lack of information on which to base a purchase.

While these concerns will certainly hamper the growth of e-commerce somewhat, they’re unlikely to stop it. A high degree of technology readiness should help keep the trend toward online buying going strong. International Data Corp. (IDC) estimates that 53% of Australian households currently have a PC; 39% are connected to the Internet; and 960,000, or 5% of the population, make online purchases from their homes.

Not only is online shopping activity in Australia increasing, it’s also becoming more varied. Many shoppers now typically visit and purchase from a wide variety of Web sites. About one-third of online buyers said they had purchased from five or more sites in the past year, averaging four sites. These buyers have made, on average, nine online purchases during the 12-month period and 24% made 10 or more separate purchases. It’s expected that online buyers will venture onto more and more sites as their comfort level with the channel grows.

The annual value of online purchases averages $800, but 17% of Australian online buyers said they spent $1,000 or more in the past year. indicating a significant group of buyers is spending large amounts online.

As Australia’s wired population becomes increasingly comfortable with online buying, retail stores can expect to feel the impact. Among those surveyed, 56% said they shop at brick-and-mortar stores less often. What’s more, respondents indicated that 57% of their online purchases are sales that would have otherwise been made in-store. This suggests that online buying will have a pervasive impact on physical stores as foot traffic in stores and malls is reduced.

However, it’s also important to note that while the majority of the country’s Web buyers shop with the intent to purchase, only 37% of their shopping occasions actually result in an online purchase. In fact, one-quarter of the online trips result in a purchase at a retail store; 10% result in a purchase being made by phone or mail order; and 28% result in no purchase at all.

Annual household income of buyers

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $30,000</td>
<td>20%</td>
</tr>
<tr>
<td>$30,000 - $49,000</td>
<td>30%</td>
</tr>
<tr>
<td>$50,000 - $69,000</td>
<td>40%</td>
</tr>
<tr>
<td>$70,000 - $99,000</td>
<td>45%</td>
</tr>
<tr>
<td>$100,000 or more</td>
<td>15%</td>
</tr>
</tbody>
</table>

Highest educational level achieved by highest income in household

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Some high school</td>
<td>13%</td>
</tr>
<tr>
<td>High school graduate</td>
<td>19%</td>
</tr>
<tr>
<td>Some college, no degree</td>
<td>13%</td>
</tr>
<tr>
<td>4-year college graduate</td>
<td>24%</td>
</tr>
<tr>
<td>Graduate school or law school graduate</td>
<td>3%</td>
</tr>
<tr>
<td>Doctoral or medical program graduate</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>11%</td>
</tr>
</tbody>
</table>

While the majority of the country’s Web buyers shop with the intent to purchase, only 37% of their shopping trips actually result in an online purchase.
Books top the shopping list

Books and computer products top the list of product categories purchased by Australian Web buyers, each bought by 45% of respondents. Other significant categories include CDs/music, at 37%, and clothing, at 25%. Some 21% bought videos; 16% bought consumer electronics; 16% have used the Web for financial services; 15% purchased food and drink items; and more than 10% bought health and beauty items, flowers or toys online in the past 12 months.

Consumers’ favorite sites clearly reflect their category choices. Leading the pack is Amazon.com, which was named by 24% of online buyers. Next in order are Myer Direct, the online operation of Coles Myer, Australia’s largest brick-and-mortar retailer, named by 17%; Dstore, an Australian online department store, cited by 14%; Wishlist, an Australian online gift store, named by 10%; and Dymocks, a Sydney-based clicks-and-mortar bookseller, named by 9% of Australian Web shoppers.

What drives consumers to these sites? Item selection and competitive prices are the primary factors. More than eight out of 10 Australian Net shoppers expect a site to have the same products as in the store or catalog, and 47% expect these to include online bargains. In the clothing, consumer electronics, toys, and health and beauty sectors, two-thirds of buyers expect online items to cost less than the same items in the store or catalog. The one exception is food and beverages, where just as many buyers (43%) expect prices to be the same as those who expect them to be lower.

Interestingly, food and beverages is emerging as a strong category among Australian Web shoppers, leading in the average number of items purchased and the amount of spending. Online buyers made eight food and beverage purchases online in the past 12 months, compared with four for health and beauty products, three for clothing, three for toys, and two for consumer electronics. The frequency of food and beverage purchases is reflected in the high total annual purchase value, at $609 vs. $449
for consumer electronics, $247 for health and beauty items, $170 for clothing, and just $95 for toys. And 68% of respondents expect to increase their online spending for food and beverages. More than half of food and beverage buyers gave the highest satisfaction rating for the overall online shopping experience and 69% gave high marks for product quality. Food and beverage e-tailers also did well in areas such as customer service, product selection, and ease of use.

The health and beauty sector also shows potential for future development, with 55% of online buyers expecting to increase the value of their purchases in this category in the coming year. Satisfaction levels were fairly high, with 53% awarding the highest marks for the overall experience and 60% giving high marks for product quality. In addition, e-tailers in this sector received good scores for ease of use and item selection.

The apparel category is emerging among Australian Web shoppers, with 13% making five or more online clothing purchases in the past year. Some 53% expect the value of their online clothing purchases to increase in the next 12 months. However, customer satisfaction with online apparel buying appears to be average at best. Only 40% of clothing buyers gave the highest satisfaction rating for their overall online shopping experience.

Australian consumers were even less pleased with their online electronics buying experience. Only one-third gave the highest marks for overall shopping experience, although, again, about half said the sites did well with product quality. Satisfaction with consumer electronics e-tailers fell off when it came to factors such as shipping costs, special offers, price and customer service.

The Australian online toy business is getting off to a slow start, with almost half of buyers expecting the value of their online toy purchases to stay the same in the next year, and 13% saying it will decrease.
However, in what may seem like a contradiction, this apparent lack of enthusiasm for online toy shopping belied higher-than-expected satisfaction ratings. Half of toy buyers awarded the highest marks for the overall experience, and more than half rated sites highly for ease of use, product quality, and customer service.

Focus on the future
What will it take to keep Australian consumers coming to the Web and buying? Lower prices and lower shipping costs are the key factors, with more than half of buyers citing these as improvements they’d like to see. In addition, 49% said free shipping would get them to visit a site more often, with loyalty programs a distant second at only 17%. Consumers also mentioned a total guarantee of security and privacy, wider product selection, and more information about products as improvements they’d like to see in Internet shopping.

Lower shipping costs will not only attract more online buyers, but will likely keep them shopping as well. Three-quarters of Web buyers have abandoned their online shopping carts, with 38% citing high shipping costs as a key reason. In addition, 40% said they abandoned their cart because they only wanted to check prices.

Although deterred by the costs of shipping, online respondents do not consider problems related to fulfillment and customer service as significant enough to stop them from shopping online. Half of Australian online shoppers have experienced no problems related to fulfillment or customer service. And of those who have had problems, 73% said it will have little or no effect on their online shopping, although 21% said they will no longer purchase from an individual Web site.
The competitive battle that ensued following the launch of the first free ISP service in late 1999 did much to build awareness of the Internet among Brazilians. The problem for e-tailers, however, is that access and awareness are not translating into online shopping. Thus far, Brazilian consumers have not demonstrated a high level of interest in e-commerce, although most observers expect that to change as Brazilians become more comfortable with the Internet.

Brazil boasts a substantial economy and a fair number of wired consumers, but the challenges facing e-tailers are monumental and include a weak infrastructure and telecommunications industry, a lack of governmental regulation, and a significant language barrier. Getting past these roadblocks will be the key to the future of B2C e-commerce in Brazil. Unfortunately for businesses, many of these factors are out of their control.

Brazilian e-tailers can pin their hopes, however, on the potential for consumer demand to push the government and the telecommunications industry to step up the pace at which they address some of the critical inhibitors to online shopping. While only 1% of Brazilian households are online, there’s agreement that the growth rate over the next five years will be exponential, driven in part by the fact that most ISPs now offer free Internet service.

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It’s also clear that Brazilian e-tailers must address the issue of language on the Internet. The bulk of the country’s Web sites are in Spanish, yet consumers have made it known that they prefer to access sites in Portuguese. Fixing this problem is certainly within the control of e-tailers and they would be remiss to ignore consumers’ wishes.

The issue of infrastructure
The ability of companies to control other problems, however, is not so clear-cut. The country’s unsophisticated infrastructure, for example, remains an enormous obstacle to e-business growth. The business environment in general is marked by a lack of efficiency and the postal service, which handles the bulk of e-commerce deliveries, is considered weak and inefficient, although recent investments in new technology may help remedy that.

Similarly, the telecommunications industry’s infrastructure is weak and expensive, with limited DSL, ISDN and broadband services. However, there’s some indication that these are beginning to grow as a result of privatization.

The government’s role in e-business has been limited to date, and that’s proved to be a problem. With little regulatory control, pirated software abounds, hackers have wreaked havoc, and support for e-commerce development remains low. The good news is that this appears to be changing, which will be a crucial factor for the future of e-business in Brazil. So far, legislative attempts to provide regulations relating to Internet security, privacy, and taxation have gone nowhere.

Despite the barriers to B2C e-commerce, Brazilian companies are rapidly launching sites in order to gain a presence on the Web so they’re ready when the consumers arrive. Sectors such as auto retailing, banking, financial services and real estate have grown significantly on the Internet.

A number of Brazil’s traditional retailers have launched online operations. For example, Livraria Siciliano, Brazil’s largest bookseller, came early to the Net with its online site (siciliano.com.br) and boasts a wide product selection that includes computer...
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Software, DVDs and VHS videos, and CDs, in addition to books. And the online store of supermarket operator Se Supermercados (sesupermercados.com.br) features an offering that consists of several thousand items ranging from fresh fruit and vegetables to health and beauty care to pet food.

It’s expected that the country may see an increased number of pure-play start-ups due to the fact that the Internet is exempt from Brazilian law that prevents local or foreign companies from owning an interest in Brazilian media companies. This should make alliances between companies easier and open the way for venture capital firms to invest in entrepreneurial pure-plays. In addition, Brazil was not hit as hard by the dot-com shakeout that affected the VC market in many countries. Several pure-play e-tailers and portals secured large amounts of financing last year, although expectations are that the Brazilian venture capital market will begin slowing down a bit.

At this point, the chances of profitability any time soon for e-tailers — both brick-and-mortar operators and pure-plays — would seem unlikely. Costs, particularly in areas such as fulfillment and advertising, far outstrip sales. It's likely that e-tailers will begin to fall by the wayside if they can’t reverse that trend sometime in the near future. Witness Super11.net, a portal offering free Internet service that closed its doors this past fall after less than a year in business. A disturbing note was the fact that the company was backed by Banco Safra, a well-financed Brazilian bank. If others fall victim to the same type of financial difficulties that haunted Super11, the availability of venture capital, not to mention the future of the free access model, are sure to be called into question.
Brazil: Catching on Fast

They may be new to the Net, but Brazilian consumers have increased their online buying significantly, with rapid growth expected in the future.

E-commerce in Brazil is in the early stages of development. Only 6% of households have PCs, 1% with Internet access, and less than 1% of the total household population has purchased online. However, as this changes, online buying will become increasingly commonplace. Eight out of 10 of the fact that many of the country’s e-commerce sites are not yet operating with secure servers. More than two-thirds of Web users cited concerns about the use of credit cards online as the leading reason for not making online purchases. In addition, 55% said they prefer to see and feel products first. Other complaints included a lack of confidence in online merchants, the lack of a credit card, too little product information, and the length of time for the transaction process.

Brazilian online shoppers saw both the number and value of their Internet purchases increase in the past year. Among Brazilian Web users, 55% have purchased an item online in the past 12 months, and 89% expect to shop the Net in the next year. Those who aren’t buying online point primarily to one key problem — credit card security, a fear that may be justified given the fact that many of the country’s e-commerce sites are not yet operating with secure servers. More than two-thirds of Web users cited concerns about the use of credit cards online as the leading reason for not making online purchases. In addition, 55% said they prefer to see and feel products first. Other complaints included a lack of confidence in online merchants, the lack of a credit card, too little product information, and the length of time for the transaction process.

Reflecting the early stage of online shopping in Brazil, Web buyers typically visit and purchase from a select number of sites. Almost three-quarters of those who have made a purchase said they have bought from five or fewer sites in the past 12 months. And their spending levels are still fairly low, compared with more experienced Web buyers. On average, Brazilian shoppers made nine online purchases, with the annual value averaging $493, while U.S. buyers made about 13 online purchases for an average value of $896. Also typical of less-experienced Net shoppers, Brazilian online consumers prefer to shop at sites that specialize in the particular items they offer rather than broad-line retailers.
Reflecting the early stage of online shopping in Brazil, Web buyers typically visit and purchase from a select number of e-tailers.

CDs and books dominate Brazil’s Internet shopping lists, with 70% of buyers having purchased CDs/recorded music and 60% having bought books online. Other popular categories include computer products, videos, and consumer electronics. While tickets/reservations were purchased by just 10% of Web buyers, the category has shown good growth and appears to be an emerging opportunity in the Brazilian e-business market. Other growth opportunities include food and drink and flowers, which have made headway in the past year.

Food and beverages: Opportunity knocks

In fact, the number of online food and beverage purchases made in Brazil far outdistances purchases in categories such as health and beauty products, clothing, toys, and consumer electronics. Online buyers made almost six food and beverage purchases during the past 12 months, with an average annual value of just over $400. And 72% of buyers expect to increase their online spending for food and beverages in the next year.

The online apparel sector remains quite undeveloped in Brazil. Only 9% of online shoppers made apparel purchases and the majority made just one or two online clothing purchases in the past 12 months. The average value of those purchases was only $110, far below the amount spent on food and beverages and just edging out the value of consumers’ online toy purchases. The good news is that almost three-quarters of respondents said they expect to increase the value of their online clothing purchases during the next year. The biggest deterrent to apparel buying on the Web is the inability to try on items for proper sizing, a factor cited by 60% of Brazilian respondents.

In the consumer electronics sector, the average number of online purchases was low, at just two in the past 12 months, yet the value of those purchases, at $332, was second only to food and beverages due to the products’ higher price tags. As with apparel, consumers expect to increase the value of their online consumer electronics purchases in the coming year.

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The opportunity for development in the health and beauty segment might be a bit lower, given that just 46% of consumers expect their spending for online health and beauty purchases to increase in the next year. Nearly as many, 41%, expect their spending to remain the same. Online buyers are spending an average of $118 on their annual purchases in this category, well below the amount spent on food and beverages.

Do Brazilian online shoppers like what they get? For the most part, the answer is “yes.” Most consumers said they were very satisfied with the product quality in all sectors when buying online. They also gave retailers in all product categories good marks for ease of use and customer service. However, the ratings were a bit lower in areas like product selection and prices. In fact, Brazilian shoppers make it clear that they are looking for online bargains, with the vast majority of consumers indicating that they expect prices on the Web to be lower than those in stores for all product sectors. Brazilian consumers appear to practice what they preach in this regard and can be lured into buying when the price is right. More than two-thirds of Web buyers have made unplanned purchases while shopping online, primarily because the item was on sale.

The issue of language is important to Brazilian consumers, who have indicated that they prefer to access sites in Portuguese. English may be the common language of the Web, but it doesn’t play in Brazil. Consider the list of favorite Web sites named by Brazilian online buyers. Leading the list is Submarino, a Spanish and Latin American site selling books and music, which was named by 34% of respondents. Rounding out the top five are Lojas Americanas, a Rio de Janeiro-based discount retailer, cited by 26%; Saraiva, which sells books, CDs, and videos and was named by 20% of respondents; Amazon, named by 18%; and Siciliano, the country’s largest bookseller, named by 14%. The only other U.S.-based site to make the list was Barnes & Noble, cited by just 4% of respondents.
Future shop

Although Brazilian consumers qualify as Net neophytes, their comfort level with online shopping is growing and it’s likely to impact how they shop in physical stores. Almost two-thirds of online buyers said they shop at retail stores less often, although 33% indicated that their online shopping trips actually resulted in a purchase at a retail store.

Despite overall satisfaction with their online shopping experiences, Brazilian consumers issued a number of complaints that echo those of more experienced Web buyers. Personal sizing was named by 62% of respondents as a reason not to shop online, followed by high shipping costs, which was cited by 45%. And there’s clearly some room for improvement on the part of the country’s e-tailers when it comes to certain problem areas. Forty-three percent of Brazilian online buyers said they have experienced problems with online shopping, ranging from goods not being shipped to billing problems to customer service issues. However, 60% of them said it will have little or no effect on their online shopping.

What do Brazilian Net shoppers have on their wish lists for the future? Similar to online buyers in other countries, lower prices and lower shipping costs are the leading improvements they would like to see. Three-quarters cited lower prices and 58% named lower shipping costs, and more than half said free shipping would cause them to visit a Web site more often. Loyalty programs ranked second, but were named by just 17% of respondents.

Do Brazilian online shoppers like what they get? For the most part, the answer is “yes.” Most consumers said they were very satisfied with the product quality in all sectors.
Canadian E-Tailing: Competitive Pressures Hamper Growth

By Guy Frechette, National Industry Leader, Retail & Consumer Products and Ben Babcock, Corporate Finance Industry Leader, Retail & Consumer Products

To date, Canadian retailers have been slow to aggressively pursue the online market, as they struggle with a number of business issues. Competitive pressure from U.S. companies tops the list. The size and proximity of American competitors, as well as their increasing penetration into the Canadian market, are at the root of the problem. Although some Canadian retailers are beginning to develop a Web presence, most are more concerned with getting their overall business strategies in order in an effort to strengthen their position against American operators. The competitive environment, coupled with Canada’s sheer physical size, has resulted in lower profitability for Canadian retailers, another factor that has kept many from pursuing an online strategy. An additional concern is the uncertainty about the potential size and future profitability of the e-tailing market.

The Canadian investment community thus far has not pressured companies to establish e-commerce strategies, focusing instead on retailers’ overall competitive position, of which an e-commerce strategy is one part. In addition, the venture capital community is not very mature, leading some Canadian retailers to turn to American capital markets for financing.

There are few pure-play e-tailing operations in Canada, and most are reducing their advertising and operating costs in an effort to slow their cash-burn rate. The Canadian stock market, like its U.S. counterpart, has become increasingly focused on the issue of profitability. In the current environment, it is unlikely that the market will tolerate continuing losses from e-tailing operations without a clear view of when these operations will become cash-flow positive.

For bricks-and-mortar operators, internal funding also is likely to be limited as companies look cautiously at the online retailing market. In general, Canadian retailers are not as well capitalized as American operators and do not enjoy the scale advantages of the U.S. market to aggressively fund Web-based strategies. Many Canadian companies have focused on...
The venture capital community is not very mature, leading some Canadian e-tailers to turn to American capital markets for financing.

Managing the risk/return profile of investments until the prospects for the online channel are better understood.

E-tailing development will not accelerate anytime soon, but when it does the country is well-equipped to handle an expanded e-commerce market. Not only does a substantial portion of the population own a personal computer and have Internet access, but PC penetration is expected to grow at a quick clip due in large part to the competitive computer market, which has kept PC costs low and availability high. In addition, Canada’s phone system is reliable, the banking and financial services industry is ahead of the curve with respect to retail delivery of products and services, Internet access charges are fairly low, and the government has actively supported the development of an Internet infrastructure.

Picking the players

Identifying the key players in the B2C e-commerce market isn’t easy as few Canadian companies have emerged as dominant etailers. However, Chapters has already developed brand equity on the Internet. In fact, the country’s leading bookstore has exceeded Amazon.com and Barnesandnoble.com in site popularity among Canadian consumers. Other traditional brick-and-mortar retailers like Sears Canada, Canadian Tire Corporation, Mark’s Work Wearhouse, a specialty menswear chain, and Future Shop, a specialty computer and electronics chain, are taking a measured approach to e-tailing. Multi-channel operators face a variety of challenges, particularly fulfillment issues and building volume. According to the companies that we interviewed for this report, the online channel is important to extending the brand and driving revenue growth, but less so with regard to marketing or driving traffic to the physical stores. Companies are cautious as they attempt to develop their online business, with the goal of profitability clearly in their sights. States one executive for a Canadian retailer: “The company’s whole focus is to go very slowly, build on our existing systems and avoid incremental costs so our revenue will be greater than the costs. In other words, the e-business will be profitable.”

Few pure-play Web startups have developed a significant market position. However, an interesting development was the launch in July 2000 of Empori.com, which claims to “blend the virtual and physical to create an entirely new marketplace.” The company operates brick-and-mortar depots to which consumers may have products from selected etailers shipped for pick-up. Empori, a division of Oxford Properties Group, a leading Canadian developer and property management firm, operates a number of depots in Canada and plans to open several in the U.S. as well. Empori customers can shop online at any of the businesses that have partnered with Empori. After placing an order, a consumer selects the Empori outlet where he or she would like to pick up the items purchased. The deliveries are...
stored in a supervised personal locker or at the depot’s service counter until the consumer arrives to pick them up.

At this point, most Canadian e-business models are works in progress. Customization of merchandise mix and marketing to customers varies from one e-tailer to another, with little standardization. Generally, the breadth and depth of product mix and the degree of customization are not as great online as they are in physical stores.

Pricing on the Internet tends to be about the same or, in some instances, lower than in stores — a strategy that should be well-received by Canada’s price-sensitive online shopper. However, delivery costs remain high because of the expense of maintaining an effective logistics operation to service a geographically dispersed population. Distribution models are varied and include direct ship, shipment via a distribution center, store pick-up, and outsourced arrangements. Most Canadian retailers operating on the Net track customer purchasing patterns, but the use of this data for loyalty programs and targeted marketing varies significantly.

Most Canadians are using the Web for price comparisons and product research, but as their comfort level begins to grow, cybershopping appears poised to explode.

The future: White space opportunity?
The best news for Canadian e-tailers going forward may lie in the fact that so many of the country’s consumers are online yet so few are buying over the Net — at this time. That leaves plenty of opportunity for growth. Most Canadians are using the Web for price comparisons and product research, but as their comfort level begins to grow, cybershopping appears poised to explode.

However, if the past is indeed prologue to the future, the biggest challenge for Canadian companies is likely to be grabbing this business before U.S. e-tailers get hold of it.
Canadian Consumers Test the Web Waters

Despite a high degree of technological sophistication, Canadian consumers have been slow to take to online shopping, but the pace is expected to quicken as they become more comfortable buying over the Web.

Canadian consumers represent something of a contradiction when it comes to e-shopping. On one hand, they’re tech-savvy, with the highest levels of PC penetration and Internet access in our research. Some 57% of households have PCs, 50% have Internet access, but only 8% of the population made online purchases from home in the past 12 months. In addition, only 53% have purchased an item on the Internet in that time, a considerably lower percentage than in countries such as Germany (where 78% have shopped online), the United Kingdom (76%), the U.S. (74%), and Switzerland (73%). And they barely edged out countries like Israel (50%) and South Africa (48%), where Internet access is far lower than in Canada.

What’s keeping Canadian consumers from buying on the Net? According to our respondents, credit card concerns are the primary impediment, named by 60% of Web users. In addition, 56% said they will not purchase online because they prefer to see and feel the products first; 39% do not have a credit card; one-third lack confidence in online merchants; and 19% don’t like the fact that they cannot talk to a salesperson.

Some 57% of households have PCs, 50% have Internet access, but only 8% of the population made online purchases from home in the past 12 months. In addition, only 53% have purchased an item on the Internet in that time, a considerably lower percentage than in countries such as Germany (where 78% have shopped online), the United Kingdom (76%), the U.S. (74%), and Switzerland (73%). And they barely edged out countries like Israel (50%) and South Africa (48%), where Internet access is far lower than in Canada.

What’s keeping Canadian consumers from buying on the Net? According to our respondents, credit card concerns are the primary impediment, named by 60% of Web users. In addition, 56% said they will not purchase online because they prefer to see and feel the products first; 39% do not have a credit card; one-third lack confidence in online merchants; and 19% don’t like the fact that they cannot talk to a salesperson.

The pace of B2C e-commerce in Canada is likely to pick up soon, however. Almost three-quarters of Web users said they...
Consumers

The pace of B2C e-commerce in Canada is likely to pick up soon. Almost three-quarters of Web users said they expect to make a purchase online in the next 12 months.

Many Canadian online consumers are still somewhat tentative in their buying, sticking to a small number of favorite sites rather than venturing farther out into the wired world. On average, respondents have purchased from four sites in the past 12 months. The good news, though, is that a small group of Web shoppers (29%) have become more adventurous and have purchased from five or more sites. That number can be expected to grow as Net shoppers become increasingly comfortable buying online.

The scope of buying grows

Those consumers who are buying over the Web made an average of eight online purchases in the past 12 months, for an average annual volume of $590. Many of these shoppers have begun to expand the scope of their online buying, purchasing from categories outside of books, CDs, and computer-related items. One-quarter of Canadian online buyers have purchased clothing over the Web; 17% have purchased consumer electronics and toys; and 15% said they have made purchases from “other” categories such as antiques, arts and crafts, hobbies, pet supplies, auto parts, tools, and baby items.

While U.S. sites are popular in Canada, many consumers also shop with Canadian-based companies. Leading the list of favorite sites was Chapters.ca, named by 27% of respondents, followed by Sears Canada (24%), Amazon (16%), Future Shop, a Canadian click-and-mortar operator that sells computers, videos, audio, music, and other categories (15%), and eBay (8%). The remaining sites on the list were named by...
In general, Canadian online buyers are relatively satisfied with their shopping experience, giving sites good marks for ease of use, product quality, pricing and selection in most sectors.

just 5% or fewer online buyers and included a number of book, music, and computer sites such as Barnes & Noble, Radio Shack, Sam the Record Man, and Egghead.

The majority of Canadian online buyers list “good selection of items” and “competitive prices” as the primary reasons for shopping at their favorite sites. In the case of sites operated by brick-and-mortar or catalog retailers, most online buyers expect the Web site to have the same products as the store or catalog, and 59% expect these to include online bargains. That’s true for all five sectors studied (clothing, consumer electronics, toys, food and beverages, and health and beauty), with consumers indicating that they expect online items to cost less than the same items in the store or catalog.

As Canadians begin to move into online buying, the impact is being felt by physical stores in several ways. Consumers shop the Web with the intent to purchase online, yet only 31% of these shopping trips result in an online purchase. A similar number of trips actually result in a purchase at a retail store, 8% result in a purchase by phone or mail order, and 30% result in no purchase being made at all. The overall effect on retail stores, however, is that more than half of online buyers said they shop at physical stores less often than before. In addition, 55% of Canadian online purchases are sales that would otherwise have been made in stores. However, consumers indicated that in categories such as perishable products and high-ticket items, they are more likely to do research and other purchase preparation over the Internet and then buy the product in the store.
Sales by sector: Clothing gains ground

The impact of online buying is likely to vary considerably by sector, however, as consumers test a variety of categories. Compared with some countries, only a small percentage of Canadian online buyers — 4% — purchased food over the Web. Average annual online spending for food and beverages totaled $126. By comparison, U.S. online shoppers spent $197 for food and beverages annually. Looking ahead, nearly nine out of 10 Canadian online food and beverage buyers said they expect to increase their spending on these items in the next year.

Online buying activity was much greater in the apparel field, where buyers made an average of nearly five clothing purchases online in a year. By comparison, Canadians made four food and beverage purchases, three in the toy sector, three in consumer electronics and just two in health and beauty. In addition to the highest number of purchases, clothing trailed only consumer electronics in terms of average annual expenditure, with consumers spending $180 on online apparel purchases. Half of online clothing buyers said they expected to increase their purchases in the coming year.

Consumer electronics registered a low frequency rate for online purchases but led the sectors in average annual value, at $201, due to the impact of big-ticket items. In fact, 20% of online buyers spent $300 or more on their electronics purchases. About half of those consumers who bought consumer electronics online said they expected to increase their purchases in the next 12 months.
Consumers indicate that in categories such as perishable products and high-ticket items, they are more likely to do research and other purchase preparation over the Internet and then buy the product in the physical store.

<table>
<thead>
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<th>Turnoffs</th>
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<tr>
<td>1. Shipping cost is too high</td>
<td>51%</td>
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<tr>
<td>2. Personal sizing, fit is important</td>
<td>49%</td>
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<tr>
<td>3. Concern that credit card info will be stolen</td>
<td>29%</td>
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<tr>
<td>4. Item is very large</td>
<td>20%</td>
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<tr>
<td>5. Item is very high cost</td>
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Trailing in terms of average annual online expenditures were toys at $93 and health and beauty products at $59. And the growth potential for these sectors appears to be low. Only a little more than one-quarter of consumers who purchased these items online said they would increase their spending in the next year.

In general, Canadian online buyers are relatively satisfied with their shopping experience, giving sites good marks for ease of use, product quality, pricing, and selection in most sectors. This was true even in the food and beverage and toy categories, where buying frequency and spending were low. In the health and beauty sector, fewer consumers gave high marks for pricing and ease of use, perhaps pointing to problem areas that e-tailers in that market should investigate.

What do Canadian consumers like least about online shopping? Echoing consumer complaints in many countries, they cited high shipping costs as the biggest negative factor, named by 51% of respondents. That was followed by personal sizing, which was cited by 40% of online buyers. Again reflecting the sentiment voiced by consumers around the world, 57% of Canadian e-shoppers said that free shipping is the factor that would get them to visit a site more often, with discount coupons second at only 15%.

Although deterred by the costs of shipping, online respondents do not consider problems related to fulfillment and customer service as significant enough to stop them from shopping online. More than half of Canadian Web shoppers have experienced no problems in these areas, and 71% of those who have had problems said it would have little or no effect on their online shopping.
Growing pains have hampered e-commerce expansion in France as the population has been slow to get connected to the Internet and e-businesses have struggled to iron out their business models. But with the awkwardness of youth almost behind it, the French online retailing market shows every sign of taking off, as it races to catch up with central Europe.

Driving e-commerce growth in France are a number of factors, including the fact that well-known bricks-and-mortar companies such as Group Pinault Printemps and Group Louis Vuitton Moet Hennessy are going online. In addition, Internet access is becoming easier. Most French ISPs offer a variety of plans, and some offer free Internet access. These and other factors are expected to boost online user penetration levels significantly over the next few years.

Taking up the e-commerce cause

Several broader societal issues also bode well for accelerated growth of B2C e-commerce in France. For one thing, the country’s economy has been strong and is expected to remain that way. The French government has also taken up the e-commerce cause and has launched a campaign to promote the Internet and build awareness among consumers. Credit card security remains an issue with French consumers, although there’s some evidence that this is changing as the wired population becomes more comfortable with the Internet, and as well-known banks and insurance companies like FIA-NET.com have become involved in the transaction process. “Technologically, we haven’t encountered any security problems,” says Hervé Roche, Internet marketing manager for Go Sport (go-sport.fr), a French-based sports retailer that operates more than 100 stores in France, Belgium, and Poland. “We have not had hackers. The credit card numbers do not pass through the company but go straight to the bank. The security system is not a major problem, and it’s as easy as ordering through the phone line, but a lot more secure.”

Potential regulatory controls should help ease security concerns as well. A law designed to guarantee the security of Internet transactions is now working its way through the legislative process.
It is very much a transitional time for online retailing in France, especially as traditional brick-and-mortar retailers begin to move into this channel.

In addition, two European Community Directives about e-commerce will boost consumer confidence. These Directives provide, in particular, a right of withdrawal (return of the product) and require the consumer’s full consent before a seller can close a sale.

EC legislation also recognizes the validity of the electronic signature. Moreover, a consumer will be allowed to seek redress in his own country’s courts if there is a dispute over an online sale. Currently, in accord with the 1968 Brussels Convention, such disputes may fall within the jurisdiction of the consumer’s home country.

Another positive force was the development of the Nouveau Marché, the country’s high-tech stock market modeled after the NASDAQ. The market prompted a rush of IPO filings and may result in the expansion of the pure-play segment in France.

**Internet competition picks up**

Competition within the French retail business is heating up as an increasing number of companies take to the Net. Sectors experiencing growth include banking, financial services, books, music, and travel services. Given the recent development of French retailing, many companies are focusing their attention on marketing, brand extension, and driving store traffic. As consumers’ awareness and comfort levels grow, retailers’ emphasis will likely shift more heavily toward revenue growth.

In an effort to build awareness and increase traffic, some retailers are establishing alliances with other businesses, such as search engines, Web directories, and affinity sites. Such alliances can offer benefits for both parties, especially information exchange as well as increased brand exposure.

Pricing policies also vary, with some retailers matching pricing and promotions between their stores and their Web site. Generally, prices are almost never lower on the Internet, except when they are sale-priced for clearance. Again, our research shows that consumers expect low prices online.

It is very much a transitional time for online retailing in France, especially as traditional bricks-and-mortar retailers begin to move into this channel. For these companies, there is a significant opportunity to offer not just a new service, but more value to both customers and shareholders.
French Consumers Stepping Up Their Online Purchases

Despite low Internet penetration rates, French consumers are quickly making up ground in the online shopping race.

The growth is likely to come as Internet access increases. International Data Corp. (IDC) estimates that 33% of French households have a PC, 17% of households are connected to the Internet, and 4% of the population have made purchases online from home. These numbers will likely increase significantly in the next few years. But not before French consumers get past hurdles such as fears about online credit card security and the inability to see what they’re buying. Three-quarters of consumers indicated that concerns about credit cards was the primary reason they will not make online purchases, and nearly two-thirds said they will not buy over the Net because they prefer to see and feel products. Consumers also indicated that they lack confidence in online merchants and some simply find the whole Internet buying process too confusing.
As their familiarity with online shopping increases, however, French consumers are exploring the Web a bit more. They now typically visit and purchase from a variety of different sites. Close to half of those who have made an online purchase said they have bought from five or more sites in the past 12 months. On average, respondents have purchased from seven sites and have made 9.5 online purchases in the past year. Roughly half of French online buyers claimed that during the prior 12 months they had greatly increased the number of items purchased online, as well as the annual value of their online spending, which averaged $709.

Category close-up: Books lead the way

These purchases have been made in a number of different categories. More than half of French online buyers have purchased books and computer products, while 44% have bought tickets/reservations, and 43% have purchased CDs and recorded music. After the top four categories, there is a significant drop-off in the percentage of buyers in the remaining sectors. At the bottom of the category list are such categories as flowers, health and beauty, toys, large household goods, and car rentals.

While Amazon leads the list of favorite sites, named by 22% of online buyers, French e-tailers round out the top five. Book vendor FC and SNCF, the French national railways company, cited by 20% and 18% of respondents, respectively, follow in the number two and three spots, with Alapage, featuring books, music, and videos, named by 10%; and Degriftour, a French travel site, cited by 7%.

Of the five key sectors studied for this report — food and beverages, consumer electronics, clothing, toys, and health and beauty — food and beverages led the list in terms of average annual number of purchases, at five, followed by health and beauty at four, toys at four, clothing at three, and consumer electronics at two. Food and beverages also led the sectors in annual value of online purchases, at $447, ahead of health and beauty at $315, clothing at $167, consumer electronics at $118, and toys at $108. The good news for the future
Overall, Web buyers in France seem fairly pleased with their online shopping experience. However, consumer electronics sites scored poorly in overall experience, ease of use, and special offers. These poor scores may be due to the fact that many of the sites are fairly new and French consumers are not yet buying these products online to any great extent. Time and experience will no doubt improve the performance ratings for these e-tailers in the future.

The ultimate impact on physical stores in France as a result of online buying remains to be seen. Half of online buyers said they shop at retail stores less often, although 23% said online shopping has actually increased their shopping at brick-and-mortar stores. And, in fact, Web buyers noted that 55% of their online shopping trips resulted in a purchase being made at a retail store, while just 25% of those trips resulted in an online purchase, which would seem like good news for the nation’s physical-store retailers. However, that may change as consumers become more experienced in shopping over the Internet. For the moment, consumers’ continued reliance on physical stores could prove to be an opportunity for click-and-mortar operators to drive sales if they do a good job integrating the two channels.

What buyers want: Selection and price

The majority of French respondents are looking for two things online: good selection and competitive prices. As is true with Web shoppers in most countries, this translates into an online product mix that duplicates the selection in the store or catalog, along with online bargains and specials.

Overall, Web buyers in France expect to increase online spending in these categories, with most of the remaining buyers expecting spending to remain the same. The number was highest for clothing, where 75% of online buyers said they will spend more in this category in the next 12 months, followed by food and beverages, with 72% expecting their purchases to increase.

Overall, Web buyers seem fairly pleased with their online shopping experience. A substantial percentage gave e-tailers in most categories good grades for product quality, pricing, ease of use, and item selection. However, consumer electronics sites scored poorly in overall experience, ease of use, and special offers. These poor scores may be due to the fact that many of the sites are fairly new and French consumers are not yet buying these products online to any great extent. Time and experience will no doubt improve the performance ratings for these e-tailers in the future.

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Most buyers expected to see lower prices online than in the stores for the same products, except in the food and beverage sector, where 56% of respondents expect prices to be the same online as in-store. In addition, almost half of French online buyers said the high cost of shipping was the biggest factor keeping them from purchasing online.

Given a wish list of changes that could be made in the online shopping experience, what would French consumers put on it? Unlike buyers in many countries who pointed first and foremost to reduced shipping costs, the French identified lower prices, named by 59%, as the leading improvement they’d like to see in Internet shopping. However, 45% would like to see lower shipping costs as well. Free shipping was cited as the factor most likely to get them to visit sites more often.

As in many countries, French consumers do not consider problems related to fulfillment and customer service as significant enough to stop them from shopping online. In fact, more than half of French online shoppers have experienced no problems related to fulfillment and customer service, and 35% of those who have faced problems said it will have little or no effect on their online shopping. However, 53% said they will no longer purchase from particular Web sites because of such problems.

The ultimate impact on physical stores in France as a result of online buying remains to be seen.
German e-tailers face a huge challenge in the form of U.S. domination of the German B2C e-commerce market. Companies such as Amazon, Yahoo, America Online, MSN, and Netscape have a strong — and growing — presence in the German e-tail market. Many of the major German brick-and-mortar retailers have yet to develop an online operation. If they don’t act fast, they stand to miss what many believe to be one of the strongest e-commerce growth markets in Europe.

The country’s signs of readiness are promising. Technology developments, for example, point to the potential: The telecommunications market and infrastructure are sophisticated and competitive; the hotly contested ISP market has led to favorable pricing programs from German providers such as Deutsche Telekom as well as U.S.-based companies like AOL and Dell; the high-speed access market is developing rapidly; and both PC usage and Internet access are high. International Data Corp. (IDC) describes Germany as “the market with the most potential for growth of Internet users in absolute terms,” largely due to the fact that usage of ISDN services is the highest in Western Europe.

B2C revenue is likely to increase exponentially as more of the country’s big retailers launch their Web operations.

Other factors also promise to drive e-commerce growth in Germany. The country has a well-developed mail-order industry, which has established a strong presence on the Net. In addition, online banking and financial services have become popular, helping to provide a comfort level among consumers when it comes to making transactions over the Web. Government support of e-business has been strong, including the introduction of a national technology plan late in 1999, as well as a willingness to allow the hiring of non-German high-tech employees in order to fill the void that exists in the country.

In addition, the government is examining the possibility of tax cuts on stock options, which could be a boon for pure-plays. However, many analysts expect a shakeout to hit the dot-com market sometime soon.

With numerous positive factors in place, the German e-commerce business appears ready to explode. B2C revenue is likely to increase exponentially as more of the country’s big retailers launch their Web operations. While a few physical-world companies, such as publisher Bertelsmann; OBI, which operates DIY home...
Germany has been called “the market with the most potential for growth of Internet users in absolute terms,” largely due to the fact that usage of ISDN services is the highest in Western Europe.

improvement centers; and clothing company Karstadt, have opened online stores, the B2C market at the moment consists largely of mail-order companies and pure-play start-ups.

Competition in the books and music categories, in particular, is heating up as the market gets stronger and well-financed start-ups increase their online presence.

“We see that there is lots of competition in this field and that they are working out their numbers differently as we are a traditional retail enterprise,” says Jens Larbus, sales manager, WOM World of Music (wom.de), which operates 21 stores across Germany. “These competitors spend a huge amount on marketing, so we are seeing a major difference in the amount spent to acquire a customer.”

The heightened competitive environment has forced many traditional retailers to adopt something of a defensive posture with their e-commerce operation. “In our segment, if you are not entering into e-commerce activities you will probably become a dinosaur and be extinct pretty soon,” says Larbus. “We waited a very long time to enter this market at the right time. We always had the feeling that players entered into this market without already having the right penetration level and brand awareness in households.”

As the market begins to unfold, brick-and-mortar retailers are using the Internet as much to build a presence, drive traffic to their physical stores, and transfer their brand online as they are to drive revenue growth. “I do not think B2C will be all that successful [in terms of revenue],” says Lars Biewald, project manager, new media-eBusiness, OBI (obi.de), a large home improvement retailer operating in Germany, Austria, Italy, Poland, Slovenia, the Czech Republic, and several other European countries. “To begin with, it is more about attracting and retaining customers to the new channel. In the mid-term, I think B2B will be more profitable for our market.” Indeed, with B2B marketplaces like the Worldwide Retail Exchange starting to establish themselves, the potential for B2B is considered to be far greater than for B2C.

Among the biggest challenges for e-tailers is the low usage of credit cards among German consumers, who favor debit and bank cards. The country’s e-tailers have turned to other forms of payment, such as cash on delivery, invoicing, and bank collection, to handle online transactions. This unfamiliarity with credit cards has led to some security concerns among consumers. However, Larbus believes that a well-known brand name can help e-tailers allay those fears. “The biggest point is the trust in the brand itself,” he says. “We do not mess customers about in the stores so why should we do that online? We are not likely to sign up to one of those ‘trusted shops’ or something like that. Our brand stands for ‘this brand can be trusted.’”
A technology barrier that could restrict future e-commerce growth is the low incidence of mobile phones in Germany. However, German telecommunications companies have spent big money to acquire third-generation mobile phone licenses, so the hurdle could be overcome soon. Larbus points out that this is a key issue and could make a real difference in building online revenue. “Currently you have to go through an ISP to get to our content,” he says. “In mobile commerce it could be direct.”

As in so many countries, the logistics of the delivery process remains an issue for German e-tailers, leading some to explore a variety of options such as using the logistics services of mail-order companies. “We are talking about logistics on a very big scale and we will have to see how this develops,” says Larbus. “We would love to have something like Kozmo in New York, where you have bicycle deliveries within six hours of placing an order in big cities. If there are solutions making up the speed of getting product to customers, then we will look at that seriously.”

German telecommunications companies have spent big money to acquire third-generation mobile phone licenses.
Germany: Connected and Consuming

German consumers are wired and buying, but online spending levels have not reached their potential and purchases are concentrated in a few categories.

Online shopping in Germany has taken off, with explosive growth anticipated in the next few years. More than three-quarters of Web users have purchased an item online in the past 12 months, the highest percentage of any of the countries studied in this report. And 92% expect to make an online purchase in the next year. What’s more, 82% of German online buyers have greatly increased the number of items purchased online, compared with the prior year.

What’s behind this growth? Technology appears to be a driving force. International Data Corp. (IDC) estimates that 35% of German households have a PC, 22% of households are connected to the Internet, and 7.4% of the population, or 6.1 million people, are buying online from home.

Although online shopping has exploded in Germany during the past year, the country’s consumers are relatively new to the world of e-commerce. Spending levels, for instance, are still low. The annual value of online purchases in Germany averages U.S. $656, below the global average of $729, and considerably below the $896 spent by U.S. online buyers.

Online buying isn’t for everyone, of course. Those Web users who continue to shy away from Net shopping point to the inability to see the products, as well as concerns about using credit cards online. In addition, 57% of respondents indicated that the lack of a credit card was a leading obstacle to online purchasing. And more than one-third said they lacked confidence in online merchants.
The majority of online purchases are concentrated in three product categories — books, computer products, and CDs/recorded music. Among German online buyers, 70% have purchased books; 60% have bought computer products; and 53% have purchased CDs and music during the past year. After the top three categories, there is a noticeable drop-off in the percentage of buyers in other sectors. For instance, tickets and reservations, videos, and clothing were bought by roughly one-quarter of respondents; consumer electronics by 19%; health and beauty products by 17%; toys by 14%; financial services by 12%; and food and drink by 10%. The remainder of the categories, including flowers, sporting goods, car rental reservations, and large household goods, were purchased by fewer than 10% of online buyers.

Food and beverages, while bought by a relatively small number of online consumers, actually led the sectors in terms of the number of purchases made in the past year, at 6, compared with 3 for clothing, 3 for health and beauty, 3 for toys, and 2.0 for consumer electronics. However, when it comes to the annual dollar value of online purchases, clothing, at $204, and consumer electronics, at $154, beat out the other sectors, owing to the higher prices of products in those categories. The average annual value of online food and beverage purchases was $116; for toys it was $87; and for health and beauty products, just $77.

Spending expected to rise
Buyers said they expected to increase their online spending in these categories, although there were significant differences in the numbers. In food and beverages, 71% said they expected to buy more online; 58% said they expected to increase their spending on toys; 57% in consumer electronics; 45% in health and beauty; and 39% in the apparel sector.

Satisfaction levels varied somewhat depending on the sector, but in general e-tailers in all sectors received high marks for product quality. A fair number of German online buyers also gave clothing e-tailers high marks for ease of use and pricing. Consumer electronics sites were...
Given German consumers’ relative inexperience with online shopping, it’s not surprising that they are visiting and buying from a fairly small number of Web sites at this point. More than eight out of 10 of those who have made an online purchase said they have bought from five or fewer sites in the past 12 months, averaging four sites overall. However, as consumers become increasingly comfortable with Internet buying, it’s expected that the number of sites they buy from will increase.

Amazon and mail-order giant Otto are the most frequented sites, with 30% and 15% of online buyers, respectively, listing these as a favorite site. Only two other e-tailers — bookseller Bol.de, named by 14%, and department store retailer Karstadt Quelle, cited by 10% — were mentioned by more than 10% of online buyers. Other e-tailers that made the list of favorite sites included eBay, named by 9% of Web shoppers; electronics e-tailer Conrad (5%); and Vitago, a multi-category retailer selling products such as fitness and sports, baby, and health and hygiene (4%).

**Top 10 purchase categories**

- **Books**
- **Computers and computer-related products**
- **CDs, recorded music**
- **Tickets/reservations**
- **Videos, filmed entertainment**
- **Clothing**
- **Electronic products, small "consumer"**
- **Cosmetics, fragrances, health and beauty aids**
- **Toys**
- **Financial services**

**Favorite sites for purchasing**

1. Amazon
2. Otto
3. www.bol.de
4. KarstadtQuelle
5. eBay
6. Ebay
7. Amazon
8. www.bol.de
9. KarstadtQuelle
10. Ebay

**Shoppers on a mission**

When it comes to their online shopping habits, Germans are consumers on a mission. The majority said they typically shop with the intent to purchase, although fewer than half of their online shopping trips actually result in an online purchase. And in 28% of the cases, their online trip results in a purchase at a retail store, while 14% of
Satisfaction levels varied somewhat depending on the sector, but in general e-tailers in all sectors received high marks for product quality. Shopping trips result in no purchase being made at all. Yet, there’s evidence that at least some German consumers are slowly being lured away from physical stores. More than half of online buyers said they shop at retail stores less often. And 60% of online purchases were sales that would have otherwise been made in stores. These shoppers said they’re attracted to the Web by product selection and price. For 34% of online buyers, good availability of items is the most important reason for shopping online; 29% expect the online site to have the same products as in the store or catalog; and 48% expect the selection to include online bargains.

What don’t German consumers like about online shopping? The lack of personal sizing, high shipping costs, and high prices were the leading complaints. More than half of online buyers said they had not experienced any problems related to fulfillment and customer service. Among those who had experienced difficulties, the major complaints were that the company was unable to ship a product or that the consumer received a different product from the one that was ordered. Three-quarters of those who cited problems said they would not be deterred from making future online purchases.

What would consumers like to see changed? Faster shipping was the leading improvement online buyers would like to see in Internet shopping, cited by 55% of online buyers. In addition, 48% said they’d like the shopping process to be faster. Lower prices, more information about products, and a total guarantee of privacy were also named, but by a much smaller percentage of consumers. Interestingly, German buyers, unlike those in many countries, put lower shipping costs way down on the list of improvements they’d like to see. It was cited by just 17% of respondents. However, 60% of buyers said free shipping of product would get them to visit a site more often, with discount coupons a distant second, cited by just 19% of buyers.
Those traditional physical-world retailers that are moving online generally have two goals in mind: to establish a Web presence and create a channel that is complementary to their brick-and-mortar operations.

With its risk-tolerant and tech-savvy culture, Israel could be expected to be an explosive market for online retailing. Yet barriers abound, preventing a realization of B2C potential. The biggest stumbling block is the scarcity of wired consumers. Only 21% of households currently have Internet access and even fewer are making online purchases. This may seem surprising in a country where the high-tech industry, and particularly the cutting-edge Internet sector, contributes significantly to the economy. In fact, the NASDAQ has many Israeli-based technology firms.

This backdrop has led many observers to predict that e-commerce in Israel will soon take off. However, little is likely to happen until retailers get past the security hurdle, which remains a chief stumbling block to Internet buying. It's a legitimate concern, given the numerous hacker-caused security breaches that have wreaked havoc on online credit card transactions in the country. To address the concern, a number of companies allow consumers to pay for their Web transactions over the phone. The introduction of debit cards for online purchases is also expected to help overcome the security issue.

Supply chain issues and infrastructure limitations have also stymied e-tailing growth. Among the barriers are the country's relatively unsophisticated road system and high tax structure for business. Access speed also continues to be an issue, as high costs and regulatory obstacles have hampered broadband development. However, the anticipated restructuring of the country's telecommunications industry is expected to drive high-speed growth in the future. Bezeq, the state-owned telecommunications firm, is in the process of expanding its Internet services, a positive sign for the future of e-commerce. It is expected to vie with several major cable operators for the high-speed market but faces regulatory restraints from Israel's Communications Ministry. Also on the plus side is the fact that Israel boasts a sophisticated banking system and a strong cellular communications industry. Government statistics indicate that there are more than 2.5 million cellular lines in a country with a population of just over six million.

Language and cultural differences among Israeli shoppers remain important issues for companies moving into the e-tailing business in Israel. Consumers in search of...
Language remains an important issue. Consumers in search of content in Hebrew or Arabic will find themselves sorely disappointed. This appears to be changing, however, as operators recognize the potential for e-tailing growth among non-English-speaking Israeli consumers.

The confluence of these factors has kept the Israeli e-commerce market from progressing out of its infancy, with just a handful of brick-and-mortar retailers moving online. Among traditional operators taking to the Net are Super-Sol (supersol.co.il), a large Israeli-based supermarket operator, and U.S.-based Best Buy. These retailers have joined the few pure-play startups, such as 4sale (4sale.co.il), that currently dominate the Israeli e-tail business. However, the startups may not get the same type of honeymoon that many U.S. pure-plays enjoyed prior to the dot-com fallout of 2000. The stock market in Israel is already showing signs of intolerance when it comes to e-tailer losses.

Those traditional physical-world retailers that are moving online generally have two goals in mind: to establish a Web presence and create a channel that is complementary to their brick-and-mortar operations. Most believe that brand extension is a key benefit that can come from taking their operation to the Internet. Far less important at this early stage of the game are issues such as driving store traffic and revenue growth. Certainly as the market begins to mature, it is expected that revenue growth will become a more important strategy. Currently, most click-and-mortar companies report that only a small percentage of their sales are coming from the online channel, but they expect that to grow steadily over the next five years, perhaps reaching as high as 25%. Most also anticipate that their Web-based businesses will be profitable in three to five years.

The online model of choice: Semi-autonomous

In most cases, companies are running their online site as a semi-autonomous operation, rather than fully integrating it into the overall business or keeping it entirely separate. However, some firms have opted for a separate management team, while others have elected to put the online channel in the hands of the existing management.

The individual elements of the Israeli online business model are still evolving as companies test the wired waters. Many physical-world operators are experimenting with a product mix that exceeds that found in their stores. And most expect to continue to broaden that mix. This may be a good strategy, as consumers in Israel — and around the world — are seeking broad merchandise assortment online. In addition...
to products, etailers are providing content such as product information, how-to advice and product suggestions.

In an effort to drive potential buyers to their sites and develop loyalty among Israel’s small but growing wired population, e-tailers are engaging in a variety of promotional activities. For one thing, their online pricing generally is lower than that in the physical stores and many say they have a separate pricing structure for their e-tail operation, driven largely by competitive concerns.

Beyond pricing, companies are using various forms of advertising and are establishing alliances with online malls and portals as they attempt to increase traffic to their sites. Many are pushing bundled offers and other types of promotions to build customer loyalty.

Reflecting the young state of the country’s e-business environment, most sites provide little in the way of customization, although a few e-tailers say they are making an effort to customize some aspects of their content. Systems development is also quite unsophisticated at this point, with little to nothing being done in the area of data mining or targeted marketing.

As they move forward, Israeli e-tailers point to several issues that will be critical to the future of their Internet businesses. Topping the list are fulfillment and customer service, followed by returns. Many click-and-mortar companies say they are planning to offer in-store pick-up for online orders as a way around the costs and difficulties associated with the last-mile delivery concerns.
the Web users surveyed have purchased an item online in the past year, among the lowest of any of the countries included in our research.

Credit card security sits at the top of the list of reasons why consumers won't make an online purchase, cited by 44% of respondents. In addition, 28% are turned off by not being able to see and feel products before they buy, and 18% said they lack confidence in online merchants.

What are Israeli online consumers buying? Books led by far: almost two-thirds of shoppers have purchased books online; 31% have bought CDs/recorded music; 30% have purchased consumer electronics; and 23% have bought computer products over the Web. Only 11% have bought health and beauty products and just 10% have purchased clothing or financial services. At the bottom of the list are categories such as toys, food and drink, car rental reservations, flowers, and sporting goods.

If e-commerce is to take off in Israel, several things must happen: The number of online shopping sites must increase significantly; Internet access must expand beyond the small percentage of consumers who are now wired to the Web; and Net users will have to be converted to online shoppers, a transformation that’s occurring slowly. PC penetration in Israel stands at 29% of households, while 21% of households have Internet access. Only half of the Web users surveyed have purchased an item online in the past year, among the lowest of any of the countries included in our research.

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Only half of the Israeli users surveyed have purchase an item online in the past year, among the lowest of any of the countries included in our research. Israeli online shoppers averaged more than seven purchases over the Web in the past 12 months with an annual value of $778. This figure approaches the annual value in the United States, $896, in part because Israeli shoppers are purchasing consumer electronics, which carry a high price tag in the country. More than three-quarters of Israeli online buyers said they have increased the number of items purchased online as well as the value of their online spending, compared with the prior year.

The shoppers who are buying online are testing a fairly extensive number of sites. Nearly half of those who have made an online purchase said they have bought from five or more sites in the past year. On average, respondents have purchased from slightly more than seven sites.

A closer look at some of the product sectors reveals a fairly wide swing in terms of the value of online purchases. At the high end is the consumer electronics category, where the average annual value of online purchases totaled $613, although the average expenditure was $200. By comparison, the average annual value of online purchases in all the remaining categories was far lower: $220 for toys, $188 for food and beverages, $184 for clothing, and $146 for health and beauty. At this point, Israeli buyers are mostly unsure about increased spending in these online categories, with the exception of consumer electronics, where 57% of respondents said they expected to increase their online purchases in the next 12 months.

The companies favored by our respondents are largely pure-play dot-coms. Leading the pack is multi-category e-tailer 4sale, cited by 23% of consumers as their favorite site. Other favorites include auction site Olsale, named by 14% of buyers; 522, an online shopping mall, cited by 11%; Hebrew bookstore Dbook, 10%; and auction site Netauction, 10%. Currently, online loyalty appears to be low among Israeli buyers.
Consumers are inclined to use search engines to access a Web site. Only 22% said they click on from a favorite file or key in the company name. Comparison shopping sites, online malls and banner ads have not proved effective in driving traffic to sites for purchases.

The impact on stores
Respondents said their online buying is affecting how they shop retail stores, with 41% indicating that they shop physical stores less often. In addition, 52% of Israelis online purchases are sales that otherwise would have been made in-store. However, many of their online shopping trips are not resulting in a purchase. In 35% of the cases, the shopping trip translates into a purchase over the Web; 29% of the trips result in a purchase being made at a brick-and-mortar store; 14% result in a purchase by phone or mail order; and about 25% of the trips do not result in a purchase at all.

To hold onto their Web shoppers, e-tailers would also do well to concentrate on factors such as product selection and competitive prices, the key reasons Israeli online buyers said they shop at their favorite sites. For brick-and-mortar and catalog retailers, offering the same items both online and in their stores or catalogs is important to these shoppers. Eight out of 10 respondents expect the online site to have the same products as in the store or catalog, and many expect them to include online bargains in all categories.
Heading consumers’ wish list for e-commerce improvements are lower prices and better selection, followed by lower shipping costs. However, nearly half of online buyers indicated that free shipping is the key factor that would get them to visit sites more often, with discount coupons second.

Deterrents to online shopping include concerns about personal sizing, credit card information and the need to see and feel a product first. Israeli online buyers are less concerned about shipping costs than consumers in many other countries. While some shoppers indicate that they have experienced problems related to delivery, much of this sentiment need not stop them from future buying. With more ease and confidence in e-commerce, consumer will seek out sites with better pricing and selection, with better service and convenience.

Trends in spending

- Average (U.S.$)
- More than $100, less than $300
- More than $300, less than $500
- More than $500, less than $1000
- More than $1000, less than $5000
- Less than $20

Trends in purchasing

- * Only purchases were financial services, travel tickets, reservations and/or magazine subscriptions.

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<td>2%</td>
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- Average #
- Have purchased online

42% 34% 29% 24% 21% 19% 18% 13% 18% 12% 6% 4% 2% 1%
E-Tailing in the Netherlands: Catching Up Quickly

Sophisticated technology and telecommunications infrastructure, strong government backing, and high PC penetration form a solid foundation for e-commerce growth in the Netherlands.

By Hans Beeftink, Director, Retail & Consumer Products, Netherlands

Dutch e-tailers are expected to move their e-commerce initiatives into high gear as they make a play for a bigger piece of the European e-business pie. Currently, the Netherlands is positioned as a strong follower in the B2C electronic commerce race, ahead of most European nations but still lagging behind Nordic countries such as Sweden, Finland, Norway, and Denmark. A number of positive factors should help the country make up ground on the leaders.

Several recent developments point to the strong technology and telecommunications infrastructure that exists in the Netherlands. Dutch telecommunications carrier KPN Telecom announced a major contract with Finnish telecom vendor Nokia that will initially provide high-speed Internet access services to four million customers in the Netherlands through the use of broadband technology. In addition, PSINet Inc., a large U.S.-based Internet carrier, opened a new hosting center in Amsterdam, providing e-business application services to companies throughout Europe. And the X-Stream Network launched its free Internet access service in the Netherlands at the beginning of 2000. In an unusual form of partnering the company is distributing its free software through alliances with Texaco, Videoland, and New York Pizza retail outlets located throughout the country, as well as through Start, a large Netherlands temporary services agency.

The Dutch government threw its support behind e-commerce in November 1999 when it issued the Dutch Code of Conduct, the first e-business code of conduct in Europe. The code is intended to increase confidence in e-business by tackling such issues as security and reliability. Additional government support has been abun-
The strongest sign of B2C e-commerce potential comes from consumers themselves. Dutch consumers are tech savvy and have demonstrated a willingness to shop online. Some 57% of households have PCs, 30% with Internet access. And 57% of Web users have bought an item online in the past 12 months.

But even with all these positive factors in place, the Netherlands still lags about a year or so behind the U.S. in terms of e-commerce. Many believe that the cost of local calls has slowed the progress of electronic commerce a bit. However, the increasing competition in the telecom market is gradually driving these costs down. Data protection and security concerns also continue to worry some Dutch consumers. As an alternative to credit cards, an online electronic debit system known as I-Pay was developed by Interpay Nederland BV and was launched in 1999 by the Dutch banks. The system uses the Secure Electronic Transaction (SET) standard and is designed to make secure payments possible both nationally as well as internationally. Jan Hol, company spokesperson for Dutch-based international retail giant Ahold, notes that with his company’s delivery service, drivers carry portable card swipes so customers can pay at the time of delivery with their bank cards.

Dutch companies of all sizes are taking advantage of the overall positive e-business environment to launch their Web operations. The State Department study found that the number of Dutch companies introducing their own home page is now growing faster than the number of first-time subscribers to the Internet. As these Netherlands-based companies take to the Net, many are finding themselves coming up against some big-time U.S. players, particularly in sectors such as books, CDs, and computer software. The State Department study reports that about 65%...
of Dutch shoppers purchase their goods and services from suppliers in the Netherlands with the remainder shopping primarily from U.S. sites.

Unlike companies in some other countries, the Dutch e-tailers interviewed by Ernst & Young are inclined to view their Web operations as part of a growth strategy, rather than as a defensive weapon or marketing vehicle. Most expect their online “store” to drive revenue growth and take on an increasingly important role in the overall business plan. Looking a few years down the road, Hol says, “We will have online access at every store. And considering the expected growth in online shopping, online services will probably become a separate responsibility within the company in terms of the distribution of goods that are ordered online. But as a concept, it will still be part of a single formula, i.e., the brand name won’t change.”

The Internet business models vary considerably from one retailer to another. In terms of product mix, some companies are offering the same products online and off, while others offer a subset of the in-store SKU’s and a few feature a broader assortment online than in their physical stores. “At the moment the volume of goods offered online is about half the size of the in-store volume,” says Hol. “We don’t expect this to swap in the near future, although we might offer products online that are unavailable in our stores. For example, if we decide to start selling refrigerators, there is not enough space in the stores. This is an advantage of the Internet.”

Most e-tailers say they are offering a large helping of product information, how-to advice and other product suggestions, in addition to the online shopping service, and they view these as important elements in their overall Internet strategy. “The Web should be used to its full capacities,” says Igor Verhoeven, e-commerce director, Free Record Shop Holding NV (frs.nl), a Dutch holding group of music chains operating in the Netherlands, Belgium, Luxembourg, Norway, Finland, and Central America. “If you don’t exploit all the possibilities, you don’t deliver full services.”

Pricing strategies vary, with some companies featuring different prices online, compared with the physical stores. “The Internet is to be regarded as an advertising medium as well as a shop,” says Verhoeven. “So it’s very suitable for special offerings and sales promotions.”

Many retail executives in the Netherlands expect to see exponential growth in e-commerce over the next few years and predict that it may account for 20% or more of their company’s total revenue. It’s no wonder, then, that analysts predict that Dutch e-tailers will succeed in making up the ground that currently stands between them and the European e-commerce leaders. As the State Department report noted: “The Netherlands is catching up quickly.”
the number of companies, including free-access providers, grows. In addition, Dutch consumers are beginning to demonstrate a greater interest in online shopping. More than half of Web users have purchased an item on the Internet in the past 12 months, and 83% expect to do so in the coming year. Only 17% of respondents said they had no plans to purchase over the Internet.

Standing in the way of increased online buying are several key obstacles. Sixty percent of Internet users said they wanted to be able to see and touch products before buying. Credit card issues are also barriers to e-commerce growth. More than half of respondents said the fact that they do not have a credit card would stop them from purchasing online, and 49% said they were uncomfortable using a credit card on the Web. Additional, though less significant, challenges include a lack of confidence in online merchants and too little information.

Several positive signs point to that possibility. For one thing, competition among ISPs in the Netherlands is heating up, as the number of companies, including free-access providers, grows. In addition, Dutch consumers are beginning to demonstrate a greater interest in online shopping. More than half of Web users have purchased an item on the Internet in the past 12 months, and 83% expect to do so in the coming year. Only 17% of respondents said they had no plans to purchase over the Internet.

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Those consumers who are buying online have made eight online purchases with an average annual value of $511 in the past 12 months. This represents a fairly substantial growth rate. One-third of Dutch online buyers said they have greatly increased the number of items purchased online and almost half said they have increased their online purchasing somewhat, compared with the previous year. Similarly, 42% report that they have greatly increased the value of their online spending and 38% say they’ve increased their spending somewhat in the past 12 months.

Dutch online buyers’ holiday shopping plans provided a clue of the type of growth in Internet buying that might be expected. More than one-third of respondents said they planned to make at least 10% of their holiday expenditures online during the 2000 season, compared with only 16% who did so the prior year. In addition, the average amount of their holiday shopping that they planned to spend online in 2000 nearly doubled, jumping to 10%, up from about 6% in the 1999 holiday season. Respondents cited convenience and time savings as the key reasons for increasing their online holiday shopping. Additional factors included less driving, avoiding crowded stores and malls and lower prices.

Category close-up: The usual suspects
Most Dutch online buyers are not doing much shopping around. Only 9% said they have purchased items from five or more Web sites in the past year. In addition, most have not yet significantly expanded the categories they shop for online beyond books, CDs, and computer-related products. Half or more of the buyers have purchased from these three sectors, but the numbers drop off precipitously after than. For instance, just 22% of respondents have purchased consumer electronics online; 20% have bought videos; and 19% have bought clothing. At the bottom of the list are categories such as toys, health and beauty, sporting goods, flowers, car rental reservations, food and drink, and large household goods.
The number of purchases made in many of the sectors is low at this point. For instance, in the consumer electronics category, respondents have made an average of two online purchases in the past year, and in clothing, they’ve made three purchases. The average annual value of those consumer electronics purchases was $473; in clothing, the average value was $166.

Yet clearly some of these buyers are not overly happy with their online shopping experience. Only 12% of online clothing buyers gave the highest satisfaction ratings to these sites for the overall experience. However, close to one-third awarded good marks for ease of use and product quality, while 20% were satisfied with the pricing and shipping costs. The ratings fell in areas such as item selection and customer service.

Among Dutch consumer electronics buyers, pricing was clearly a top-of-mind issue. Nine out of 10 said they expected the online prices of electronics products to be lower than those in the retail stores. E-tailers in this category have their work cut out for them, judging from the poor satisfaction ratings awarded by shoppers for the overall online shopping experience. While buyers were fairly satisfied with the quality of the products, poor scores for customer service and ease of use drove down the overall satisfaction ratings.

Loyalty proves elusive
Given the concentration of buying in the books, music, and computer products sectors, it’s not surprising that the list of favorite sites should be led by bookseller Bol, cited by 25% of respondents. Other favorites included apparel retailer Wehkamp, named by 22%; Buzat, a multicity site (19%); Amazon (14%); and multi-category retailer Kijkshop (11%). The remaining sites that made the list were named by a handful of respondents, pointing to a lack of customer loyalty.

Online buyers said they shop their favorite sites largely because of the selection and prices. Almost three-quarters of buyers said they expect the online sites to have the same products as in the stores or catalogs, and 40% expect these to include online bargains. In fact, across all five sectors...
spring as significant enough to stop them from shopping online. Online buyers pointed to lower prices and lower shipping costs as the leading improvements they’d like to see in Internet shopping. Also making the list were total guarantee of security, more selection, and faster shipping, although these factors were cited by fewer than one-quarter of Dutch online buyers. More than half said free shipping of product would get them to visit a site more often.

What impact will online buying have on the retail landscape in the Netherlands? While it’s still too early to tell, there are signs that physical stores will feel the effects. Already, 41% of online buyers said they shop at retail stores less often, and 61% reported of their online purchases are sales that otherwise would have been made in the store. On the other hand, more than two-thirds of buyers’ online shopping trips result in a purchase being made at a retail store. In only 26% of the cases, the online trip results in an online purchase; 8% result in a purchase being made by phone or mail order; and 31% do not result in a purchase at all.

Across all five sectors studied (clothing, consumer electronics, toys, food and beverages, and health and beauty) respondents consistently expect online items to cost less than the same products in the store or catalog.

While Dutch consumers are demonstrating a growing enthusiasm for online shopping, they also point to several key deterrents. Leading the list is the high cost of shipping, which was cited by 50% of respondents. Personal sizing was second, named by 47%. Although put off by the costs of shipping, online respondents did not consider problems related to fulfillment and customer service as significant enough to stop them from shopping online.

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South African e-tailers' relative lateness to the e-commerce game may allow them to leapfrog over years of old technology systems and infrastructure development.

In the e-business world, there’s something to be said for being a follower. While it’s true that South African retailers face major hurdles in the form of low Internet usage, logistics and fulfillment problems, and the state’s monopoly over the telephony business, their relative lateness to the e-commerce game may allow them to leapfrog over years of old technology systems and infrastructure development.

The key to online retailing in South Africa will likely lie somewhere beyond PC-based Internet access. Only 7% of all households are online, but their ranks are growing rapidly. South Africans are increasingly using the Internet for non-transactional purposes, but it may take some time for a critical mass of consumers to make the leap of faith to online shopping. However, cellular technology is a huge growth area in South Africa. With six million cellular phone users spanning a broad spectrum of the population, the country is well-positioned to reap the benefits of third-generation (3G) technology. And some analysts have estimated that cellular use will double by the end of 2001.

South Africa also has the most developed land-line infrastructure in Africa, and with deregulation of this sector set for 2002, growth in infrastructure and service levels could be substantial. Television offers another complementary channel with great potential in the country. Naspers (naspers.co.za), one of South Africa’s largest media companies, already has a significant stake in TV platforms across Africa and Asia, and also in OpenTV, considered a worldwide leader in interactive television software.

Certainly, there are stumbling blocks that face South African companies as they move into cyberspace. Logistics and fulfillment remains a severe challenge to South African retailers because of the lack of an affordable, efficient, and speedy delivery service. However, the South African Post Office does provide a comprehensive service and has a fairly wide distribution network. It is also currently engaged in an effort to connect South Africa’s rural areas. Recently, postal services were partially deregulated, resulting in an ever-increasing number of alternatives, such as Postnet and various courier services.

South African E-Tailing: Is This the Start of Something Big?

The slow development of online shopping in South Africa may prove to be a blessing in disguise, as the country’s e-tailers concentrate on developing their back-end systems in anticipation of B2C growth.

By Ian Catt, Director, Retail & Consumer Products
The state of the telecommunications market also has been an inhibitor to the growth of Internet retailing. Telkom, the state-owned utility provider, will maintain its monopoly of fixed-line services in South Africa until 2002. Telkom is regarded by many as being at least partially to blame for the low Internet usage in the country. Bandwidth remains expensive and limited (Telkom is currently testing broadband, but it is not readily available in South Africa at this point) and telephone calls are fairly costly (there are no free local calls). However, with deregulation imminent, these are issues that Telkom will likely be forced to address.

In certain sectors South Africa already has well-developed online offers. The major banks, in particular, have been among the global pioneers of e-commerce, and in other financial services areas, such as stock trading and personal finance portals, a number of niche online players have emerged. More recently, insurance companies like Old Mutual and Liberty have announced the imminent launch of respective financial services portals.

While the e-tailing sector is still relatively immature in South Africa, by all accounts there is significant potential for growth. Already some fairly high-profile dot-coms have emerged. Bidorbuy (bidorbuy.com), for instance, is an auction site that has been aggressively marketed in South Africa, and that also has a presence in Australia and India. It follows a C2C model similar to eBay, but receives no transaction fee. More recently, bidorbuy appears to be turning to B2C- and B2B-type auctions to boost revenue. This has included auctioning airline tickets to travel agents, in conjunction with Swissair and Sabena, and holding a “Siemens Day” to launch Siemens’ new WAP-enabled cell phone, an event that reportedly attracted 25,000 visitors over a three-day period.

Kalahari.net (kalahari.net) is an online book retailer that has expanded its mix to include products such as CDs. Kalahari is owned by Naspers, whose interests include M-Web (mweb.co.za), Africa’s largest ISP. Kalahari’s product offering is more limited than Amazon’s, with none of the personalization and little of the service typically associated with Amazon.

Digitalmall (digitalmall.com) operates as an online mall or aggregator, offering a click-through service to traditional retailers such as Look & Listen (books and CDs) and Incredible Connection (computer hardware/software). Digitalmall also operates Click’n Pay (clicknpay.net), which is predominantly an online supermarket.

To date, South Africa’s established retailers have been fairly cautious in their B2C initiatives. Until recently, the only major established retailer to have actively embraced the B2C channel was McCarthy Retail (mcretail.co.za). McCarthy’s mainstay is vehicle sales, with additional interests in financial services, apparel, furniture, and building supplies. About a year ago, McCarthy announced its intention to become “South Africa’s foremost electronic retailer.” In 1999 the company
launched Megashopper (megashopper.co.za), a multi-brand retail portal billed as an “online supermarket.” The site offers 48,000 items, including groceries, computers, and furniture, and claims more than 10,000 registered users. McCarthy also announced plans to join forces with Spar, an international supermarket chain, to establish a national online grocery shopping network.

On a smaller scale, Exclusive Books, one of South Africa’s major book retailers, and part of media giant Johnnic’s stable, set up an online offer (exclusivebooks.com) about a year ago. This move was undoubtedly in response to the threat that Amazon posed to their business. Without ever having directly advertised in South Africa, Amazon has, in fact, become one of the leading sellers of books in the market. Exclusive Books’ strategy, however, seems focused on using the Internet to provide a value-added service that augments their existing brick-and-mortar operation.

This past fall, activity in the B2C market began to increase. Wooltru (wooltru.co.za) and Woolworths (woolworths.co.za) launched inthebag (inthebag.co.za) as a joint venture in October. The site offers a range of Woolworths groceries and other branded goods, and provides delivery, but only in Cape Town and Johannesburg initially. It announced plans to expand into toys, gifts, CDs, and kitchen-related items. Unlike the proposed McCarthy/Spar venture, inthebag has set up its own distribution infrastructure to handle “last mile” fulfillment, though it also leverages Woolworths’ existing warehousing operation.

Perhaps the most significant development from a B2C perspective has been the launch of Bluebean (bluebean.com) and eBucks (ebucks.com) by two of South Africa’s largest banking groups, Stanbic and First Rand, respectively. At this stage, the Bluebean initiative appears to be focused primarily on creating crossover for Stanbic into online retail, rather than as a channel for consolidating existing financial services. Stanbic is looking to sign up about 100 merchants to sell goods via this portal, with a primary emphasis initially on secure online shopping. This focus is important, given a general wariness among South Africans regarding online trust, privacy, and security. The bluebean site includes a consumer loyalty program where online customers earn loyalty points (“beans”) that can be redeemed for additional purchases at the site. Although many of these initiatives have been launched as separate brands, the future trend in South Africa will probably be to view Web-related channels as a complementary rather than separate channel to the consumer.

The potential that the Web offers for direct marketing, loyalty programs, general customer relationship management (CRM), data mining, and cross-selling opportunities will no doubt spur an increasing emphasis on an integrated multi-channel approach. While some brick-and-mortar retailers have begun to test the B2C online channel, others view it as secondary to their B2B initiatives. For those operators, priority has been given to ensuring that the correct back-end systems and processes are in place to support the B2B operations.
Companies have tended to place a limited product selection on their Web site, with a focus on creating a niche lifestyle market for those goods. Cost-cutting opportunities and increased efficiencies, particularly in terms of supply chain/e-procurement and stock/inventory control, have arisen from the increased emphasis on the potential of B2B e-commerce. For example, Pick’n Pay and Shoprite, the two leading grocery chains in South Africa, have focused on developing an infrastructure on which to build effective B2B systems, but have not shown a strong inclination at this stage to get involved in B2C e-commerce.

For those that have launched B2C models, site execution remains somewhat in flux as the country’s e-tailers test different business models. Companies have tended to place a limited product selection on their Web site, with a focus on creating a niche lifestyle market for those goods. As the sites become more successful, the companies anticipate extending their inventory to a wider range of products. It is common to find South African online stores selling the goods for the same price as can be found in the physical stores. Deep discounting is relatively rare. Moreover, due to the lack of a well-developed parcel delivery infrastructure, retailers are apt to charge a delivery fee above the retail price of the goods sold on the site. This will frequently make goods sold across the Web more expensive if the total costs of purchasing, including delivery, are factored into the equation.

Logistics and fulfillment problems have led a few e-tailers to investigate flexible options. Edgars (edgars.co.za), the largest retailer in South Africa, allows customers to collect their Internet orders from the nearest Edgars store. Inthebag offers delivery until 10 p.m. to office parks and consumer homes. Extension of delivery times into the evening beyond working hours is new to the South African market, and it’s expected that other large retailers will follow suit.

Ernst & Young’s Grant Brewer and Michael Lalor also contributed to this article.
South Africa: Let the Buying Begin

As South African consumers await connection to the Net, there are signs of a breakthrough in the coming year.

Technology challenges loom large in South Africa, where online buying is in an early stage of development. Only 10% of the country's households have personal computers and just 7% are connected to the Net. However, the next year could prove to be a watershed if online buying begins to gain momentum.

Among Web users surveyed, 48% have made an online purchase, the lowest of any of the countries studied. But that could grow dramatically in the coming year, as fully 88% of respondents said they expect to make a purchase on the Net in the next 12 months. The majority of respondents indicated that in the past year they already had increased both the number and value of their online purchases at least somewhat.

The lack of technology is not the only factor hampering Internet buying in South Africa. The lack of a credit card leads the list of reasons why consumers will not make online purchases and was cited by 54% of respondents. Another significant concern is credit card security and the inability to get enough information online. And about one-quarter expressed a lack of confidence in online merchants.

While South Africans are beginning to feel more comfortable shopping and buying online, most Net users are still purchasing from fewer than five Web sites. However, as their comfort level with Internet shopping and their confidence in Web merchants increases, buyers can be expected to shop around more, mirroring the pattern of e-commerce development that has occurred in other countries. On average,
respondents have purchased from four sites and have made an average of nine online purchases in the past 12 months. The annual value of those online purchases averages U.S. $486.

Beyond the “big three”

Despite the fact that they are relatively new to the Web, South African online buyers are beginning to venture into a number of online categories. Books lead at 62%, followed by CDs at 33%, and computer products at 30%. Some 29% have purchased tickets/reservations, 14% have bought financial services, 13% have purchased videos, and 12% have purchased consumer electronics.

The list of popular sites reflects these categories of sales. Amazon is the dominant e-tailer, named by 54% of buyers as a favorite site. Also in the top five are auction site Bidorbuy, named by 15%, and online book and music retailer Kalahari, cited by 14%. Tickets and reservations are a strong e-commerce category in South Africa, which explains the presence of both Ticketweb and Computicket, cited by 20% and 14%, respectively, on the list of favorites.

Online buyers’ satisfaction ratings varied considerably by sector. The food and beverages sector came out on top in terms of overall satisfaction, receiving strong ratings for product quality, ease of use, customer service and special offers. In contrast, consumers’ overall satisfaction was lowest in the online clothing sector, with pricing, shipping costs, and the key quality measures cited as issues, although the marks improved for ease of use.

South African online consumers appear to be focused in their buying and shop with a clear intent to purchase. Only about 9% of online purchases are unplanned, and more than 60% of respondents said they had not made any unplanned online purchases at all. However, many are either not finding what they were looking for or are opting to buy elsewhere. In 46% of online shopping trips, consumers made an online purchase.
South African online buyers point to convenience, availability of items, and competitive prices as the key reasons they buy on the Internet.

However, 27% of the trips resulted in a purchase at a retail store; 4% resulted in a purchase by phone or mail order; and nearly one-quarter resulted in no purchase being made at all.

**Will stores feel the impact?**

While the impact of online buying on retail stores is now fairly small, this may change when e-commerce in South Africa becomes more developed. Among online buyers, 44% said they shop at retail stores less often, and 47% of online purchases are sales that otherwise would have been made in the store.

What do South African Web buyers look for in a shopping site? They point to convenience, availability of items, and competitive prices as the key reasons they buy on the Internet. Good selection made the list but was named by far fewer buyers. For brick-and-mortar and catalog retailers, duplicating their in-store or catalog offering on the Net is critical. More than one-third of buyers expect the online site to have the same products as in the store or catalog, and 46% expect these to include online bargains. The emphasis on low prices was apparent in the clothing, consumer electronics, toys, and health and beauty sectors, where respondents said they expect online items to cost less than the same items in the store or catalog. This was less likely to be the case in the food and beverages category, where a fair number of consumers expected the prices to be the same.

South Africans' complaints echo those of many other online shoppers. Personal sizing, shipping costs, and overall price levels are the key issues raised by buyers. Among Web users, 37% named personal sizing as a leading problem with online shopping, and 30% pointed to the high cost of shipping. And, again similar to consumers in other nations, South African online buyers cited free shipping as the number-one factor that would get them to visit sites more often. This factor was named by 42% of buyers, with loyalty programs second at just 17%.

**Favorite sites for purchasing**

1. Amazon.com
2. Ticketweb
3. Bidorbuy
4. Kalahari
5. Computicket

**Top 10 purchase categories**

- Books: 62%
- CDs, recorded music: 33%
- Computers and computer-related products: 14%
- Tickets/reservations: 13%
- Financial services: 12%
- Electronic products, small "consumer": 9%
- Videos, filmed entertainment: 8%
- Flowers: 8%
- Cosmetics, fragrances, health and beauty aids: 8%
- Sporting goods: 6%
South Africans would opt for the same type of improvements as those desired by many other Net shoppers around the world. More than half said they'd like to see lower overall prices, and 33% said lower shipping costs. Also making the list were more selection, faster shipping, and a total guarantee of security.

Consumer satisfaction seems high thus far, with 60% having experienced no problems related to fulfillment and customer service. And three-quarters of those who have had problems said that will have little or no effect on their online shopping.

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While the impact of online buying on retail stores is now fairly small, this may change when e-commerce in South Africa becomes more developed.
Spain Gets Ready to Roll

With low Internet usage among consumers, Spanish e-tailers are betting on the future — and on keeping foreign competitors at bay — as they rush to get their e-businesses up and running.

By Ricardo de Jorge, Director, Retail & Consumer Products, Spain

Despite barriers to e-commerce growth that include security concerns and low Internet usage, Spanish retailers are scrambling to build their Web operations before companies from the U.S. and other countries beat them to it. At the moment, there’s not a great deal of online business to be had in Spain, but home-grown companies are cognizant of the looming U.S. presence in Europe.

For now, most of the other factors driving Spanish retailers to the Internet are related to marketing and customer service, rather than revenue. Sales will come later; they expect. The value of non-revenue-generating activities shouldn’t be underestimated, however: “Marketing is very important and is becoming increasingly important because it is a tool to talk directly with customers,” says Elena Carasso, Internet director, Mango-Punto FA (mango.es), a women’s clothing retailer.

There is a sense that the time may be ripe to spark interest in online shopping. Spain is currently going through a period of economic boom. There are new emerging businesses and consumers may be more apt to try new products and different purchasing avenues.

But clearly, retailers have their work cut out for them as they attempt to build their online businesses. PC penetration and Web usage remain low for a number of reasons, including the high cost of computers, security concerns, lack of privacy and regulatory laws, slow access speeds, and high telephone connection charges.

Cultural issues, as well as a certain e-commerce knowledge barrier, also are viewed as stumbling blocks to the development of an online channel. Spanish consumers generally view shopping as a type of “hobby,” and as a result they enjoy shopping in physical stores and malls and like to see and touch the products they’re about to purchase. “Spanish clients buy very little online because we have good weather and we Spanish enjoy shopping,” says Carasso. “Sales online depend on the country’s culture, the client’s needs, and the commod- ity. There are some products like books that are easier to buy online. Clients need to see and touch cloth to buy it.”

Addressing the issues

For online shopping to grow, some key logistics and distribution hurdles must be surmounted. Chief among them is the country’s postal service, which has been
hit with accusations of slow delivery service and lost, damaged, and stolen products that fail to reach their final destination. Fulfillment takes on particular significance in a country where the online business is so young. Building consumer confidence in the ability to get goods delivered in a timely fashion is crucial if B2C e-commerce is to grow. To overcome fulfillment challenges, e-tailers are turning to delivery giants such as UPS and, in some cases, internal solutions. "We have our own fleet because in Spain there isn’t a delivery system for food," says Martins. Gomes Fernandes, technology and information manager, Condisline, an online operation affiliated with the Condis supermarket chain.

Another concern for retailers is a basic supply-and-demand problem when it comes to their human resources. Spain lacks an abundance of qualified personnel with the right technological expertise and skill sets to develop e-commerce. As an increasing number of businesses rush to get their Web models up and running, this problem is almost certain to worsen over the next year or so.

The good news is that many of the barriers to e-commerce development in Spain are being addressed. Take the issue of credit card security, which has caused many consumers to shy away from making online purchases. An alternative to standard credit cards was introduced in the form of a prepaid credit card similar to a prepaid calling card. "We try to sort out security by offering different payment methods because the security issue is normally associated with credit cards," says David Segura, marketing director and business development, Submarino.com, a Spanish and Latin American site selling books and music. "We try to reassure clients that their data is confidential and secure. It is a very complicated issue and we can’t count much on the bank’s support.”

In addition, the Spanish government has taken a more active role in the development of e-commerce of late. It is in the process of creating rules and regulations to govern the Internet and has committed a substantial amount of its budget to e-business growth. In addition, the government is encouraging people to study e-commerce by funding more high-tech educational programs.

Who’s doing e-tailing?

Overall, the retail sector is still in the primitive stages when it comes to their Web offerings and accounts for about one-third of the country’s total Web sites. Medium and large brick-and-mortar retailers represent the bulk of those sites, with only a handful of small retailers operating online. That’s not surprising as the large retailers are more likely to have the resources to fund an eetailing operation. For instance, mega retailer El Corte Ingles (elcorteingles.es), which sells a wide range of products, including washers, clothes, CDs, TVs, tools, and food, has a well-established Web presence. At this point, pure-play start-ups account for a fairly
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In general, most traditional Spanish retailers offer the same pricing structure in their online operation as in their physical stores. But some etailers, particularly pure-plays, expect to see the development of dynamic or personalized pricing in the future. “We believe that each client should have an individual price,” says Segura. “The loyalty program and price policy will determine a site’s success.”

Despite the immature state of online retailing in Spain, projections are positive. The explosive growth of cellular telephony in the country may signal the direction that e-commerce development will take, resulting in faster access speeds, lower connection rates and greatly expanded Internet accessibility for most consumers.

small percentage of the e-tailing business, no doubt a reflection of the nascent state of e-business in Spain and the late availability of venture capital.

Site design at this point remains fairly unsophisticated given the early stage of e-commerce in Spain. Elements such as product mix, pricing, marketing, and customer mix are still evolving and very little is being done in the way of targeted marketing or data mining. While online offerings may be limited at the moment, that’s expected to change as the market matures. “The main problem of the off-line business is that they must keep a live display and it is complicated, while online sales keep the same product display in a databank and it makes things easy,” says Segura, who notes that Submarino.com expects to expand its range of products over the next few years.
The future of online buying looks promising, though, as 89% of respondents said they expect to make an online purchase in the next year.

But for B2C e-commerce to really take off in Spain, many more consumers will need to get connected to the Net, and several substantial hurdles will have to be overcome. Credit card security is a huge issue, with 84% of respondents citing it as the leading reason for not making Web purchases. In addition, 71% of non shoppers said they will not buy online because they prefer to see and feel products first. A smaller number said they didn’t like the fact that they couldn’t talk to a salesperson, they found the process too confusing and they lacked confidence in online merchants.

Those consumers who are shopping the Web are still just testing the waters, with 59% saying they have purchased from five or fewer sites in the past year. Respondents said they have made, on average, almost 2% of households owning a PC and just 12% wired to the Web. But those who are connected are beginning to shop online.

Among the Web users surveyed for this report, 59% have purchased an item on the Net in the past 12 months, which puts Spain in the middle of the pack, compared with the other countries studied.

Spanish consumers have a long way to go to catch up to other European countries in the e-commerce market. PC penetration and Internet access remain low, with 17% of households owning a PC and just 12% Spanish consumers have a long way to go to catch up to other European countries in the e-commerce market. PC penetration and Internet access remain low, with 17% of households owning a PC and just 12% wired to the Web. But those who are connected are beginning to shop online. Among the Web users surveyed for this report, 59% have purchased an item on the Net in the past 12 months, which puts Spain in the middle of the pack, compared with the other countries studied.

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seven online purchases in the last 12 months, with an annual total value of $523. The encouraging news is that more than 80% of these buyers said they have increased both the number of items purchased online and their dollar spending, compared with the previous year.

Online buyers are beginning to purchase from a growing number of different sectors, although most of the spending remains concentrated in the traditional Web categories of books, computer products, and CDs/recorded music. Other fairly strong categories in Spain include tickets/reservations, named by 24% of buyers; consumer electronics, 22%; financial services, 21%; videos, 15%; and clothing, 12%. Food/drink, sporting goods, cosmetics/beauty, toys, car rental reservations, flowers, and large household goods all made the shopping list, but were cited by no more than 10% of buyers.

Shopping by sector
Among the sectors studied for this report (consumer electronics, health and beauty, clothing, toys, and food and beverages), food and beverages led in terms of frequency of purchase, followed closely by toys. That was true as well for the average annual purchase values, with the clothing category at the low end. Buying within most of these categories should jump, however, as the majority of respondents said they expected to increase their spending in the next year. The exception was toys, where more than half of buyers expected their spending to remain the same.

In general, satisfaction levels were mediocre across the sectors. In the clothing category, Web sites received a relatively low satisfaction score for the overall online experience, although their marks were higher for factors such as product quality, pricing, and customer service. Shoppers in the consumer electronics sector were a bit more satisfied with the overall experience, and gave good ratings to e-tailers for product quality, ease of use, and pricing. In the toy category, product quality and customer service were rated highly, but the overall...
experience received low marks. Food and beverage e-tailers were awarded mediocre satisfaction ratings in most of the measures, with the exception of product quality and ease of use. And in the health and beauty sector, only a small percentage of buyers awarded high satisfaction ratings for the overall online shopping experience, but gave sites better marks for product quality, ease of use, and selection.

Although U.S.-based e-tailers such as Amazon and Barnes & Noble make the list of favorite sites, a number of Spanish operators have a strong presence as well. Leading the list is mega-retailer El Corte Ingles, named by 25% of buyers, followed by Ibazar, a multi-category etailer that operates in a number of countries, cited by 19%; Amazon, 18%; Alcoste, a Spanish multi-category site, 16%; and Barnes & Noble, 9%.

What buying habits distinguish Spanish Web shoppers? A majority are inclined to make some unplanned purchases, with almost one-third saying that 10% or more of their online purchases are impulse buys. Those unplanned purchases are driven primarily by price reductions, or “sales.” In addition, about half of their online shopping trips result in an online purchase, while 21% of those trips result in a purchase being made at a retail store, 12% result in a purchase by phone or mail order, and 17% result in no purchase at all.

Personal-sized items, as well as products that are perishable, fragile, or expensive, are those most likely to be shopped for online but actually purchased at a store.

At this point, the overall impact of B2C e-commerce on physical stores in Spain is small, due to the limited amount of online shopping being done in the country. However, that can be expected to change if e-commerce begins to grow. Among online buyers, 48% said they shop at retail stores less often, and just over half of Spanish online purchases are sales that otherwise would have been made in stores.

Why they buy

The majority of Spanish online buyers list selection, competitive prices, and convenience as the key reasons for shopping at their favorite Web sites. For brick-and-mortar and catalog retailers, offering the
same items both online and in their stores or catalogs is critical and was cited by 61% of buyers. However, many noted that they expected the offering to include some Web-only specials.

What don’t Spanish online buyers like about their e-commerce experiences? Overall price levels, credit card concerns, and high shipping costs represent the primary complaints. Abandoned shopping carts are typically due to high shipping costs or price checking. And free shipping is cited by 60% of respondents as the primary feature that would encourage them to visit a site more often.

Although high shipping costs are an impediment for some consumers, most do not consider problems associated with fulfillment and customer service to be significant enough to stop them from shopping online. More than 60% of Spanish online consumers said they have not experienced problems when purchasing products over the Net. And 72% of those who have had difficulties said that will not affect their online shopping, although 20% would be less inclined to shop at particular sites.

Spanish shoppers pointed to lower prices, lower shipping costs, guarantees of security, and faster shipping as the primary improvements they’d like to see in their e-commerce experiences. Online buyers do not seem particularly concerned about the privacy of personal information, beyond credit card concerns. Privacy guarantees were cited by just 11% of buyers as an improvement they’d like to see in Internet shopping.

Although U.S.-based e-tailers such as Amazon and Barnes & Noble make the list of favorite sites, a number of Spanish operators have a strong presence as well.
At the e-business vanguard in Switzerland is the banking industry, with giants like Credit Suisse First Boston and UBS investing heavily in their Internet operations.

Swiss e-tailers have proved cautious when it comes to moving their operations to the Internet, reflecting consumers’ slow-but-steady approach to e-commerce. Credit card security remains a critical issue, but one that is expected to subside as more and more retailers open up shop on the Net. As the trust issue is overcome, Swiss consumers should be ready and able to jump into electronic commerce. PC penetration and Internet access are high. Forty-one percent of households have a PC and 36% are online, putting Switzerland ahead of most Central and Southern European countries in terms of consumer e-commerce readiness. A fair number of the country’s wired consumers are also buying online. According to Ernst & Young’s research, 73% of respondents said they have already made an online purchase. While the results stemmed from a small sample, it’s a promising sign of things to come for B2C e-commerce in Switzerland.

The country is well-positioned to move ahead with e-commerce as the business community and consumers prove ready. Switzerland’s technology and telecommunications infrastructure is sophisticated and equipped to handle expanded e-business. Increasing competition within the telecom business should help reduce connection costs. Swisscom, the national telephone company, has been partially privatized and several other providers have emerged, offering competitive prices. Currently there are more than 150 ISPs operating in Switzerland, including Swiss firms such as Blue Window (whose parent company is Swisscom) as well as U.S.-based companies like America Online. On the fulfillment end, e-commerce delivery is aided by the country’s well-developed road and highway system.

The Swiss government has started to become active in its support for e-commerce development. A law recognizing the validity of the digital signature has been drafted, and the government is considering other legislation aimed at electronic transactions. At the e-business vanguard in Switzerland is the banking industry, with giants like Credit Suisse First Boston and UBS invest-

Swiss E-Tailing Takes Slow-but-Steady Route

E-commerce has been slow to take off in Switzerland, largely because of security issues. But the advanced state of the country’s telecommunications industry, technology use, and infrastructure bode well for future growth.

By Manuel Aeby, Director, Retail & Consumer Products, Switzerland
ing heavily in their Internet operations. In most cases, their online banking services include securities trading and investment advice as well as account transfers, bill paying, and other standard services.

**Searching for security solutions**

By comparison, traditional retailers have been slower to move online, citing a variety of challenges. At the top of the list, by a long shot, is credit card security. “The key challenge is that customers have problems using credit cards on the Internet,” says Thomas Giger, manager, e-commerce for electronics retailer Fust (fust.ch). “Therefore, we offer another payment scheme and we deliver the product on ‘bill.’” Invoicing is a popular alternative to credit card payments.

Swiss e-tailers are also turning to third-party Internet security firms to help alleviate consumers’ fears. “We want to place very clear information on the Internet so that the customers are informed about how our security works and why it works this way,” says Christof Hauser, e-commerce market analyst for home furnishings giant Ikea (ikea.com).

Ernst & Young’s survey confirmed the hesitance among Swiss consumers to use credit cards when shopping on the Internet. According to the study, 59% of Swiss respondents said they were uncomfortable using a credit card online. In addition, 45% indicated that they did not have a credit card.

Respondents to the survey also pointed out that they prefer to see products before buying. Swiss retailers agree that this is an issue. “Customers want to see the product, especially if they’re buying video and audio systems,” says Giger, whose company operates 130 brick-and-mortar electronics stores. “Usually they compare the expensive products like TVs or home cinemas on the Internet and then they go to a shop to see them and hear how they sound before they buy. For cheaper products, they use the Internet to buy.”

Giger notes that the inability to talk to consumers is an additional challenge for companies such as Fust. “How do we solve the consultation problem on the Internet? If the customer goes into a shop, the shop assistant can ask for their requirements, but you can’t do that on the Internet,” he says. “There are no good solutions yet. We only have the possibility to offer a bigger catalog, where we describe the products better.”

Despite these concerns, Swiss retailers such as Spar, Fust, Migros and others have opened online shopping sites. These companies trail e-commerce leaders like Amazon in terms of popularity and usage in Switzerland, largely due to the fact that Amazon had a significant head start. According to Ernst & Young’s research 29% of Swiss online buyers listed Amazon as their favorite site, putting it at the top of the list.

“Customers want to see the products, especially if they’re buying video and audio systems. For cheaper products, they use the Internet to buy.”
To help drive online sales, Swiss e-tailers are relying on a variety of services such as providing additional product information, how-to advice, and other product suggestions.

**E-strategies: Marketing prevails**

Early efforts by Swiss companies are focused largely on marketing the sites and extending the brand to the Internet. Some e-tailers also are expecting their online operation to help drive traffic to their stores and build revenue growth, a goal that most say will become increasingly important as time goes on. Growth projections vary, but some companies expect online revenues to account for about 10% of their overall sales in five years, at which time they also expect to achieve profitability.

Swiss companies are approaching their online operations in different ways, although many prefer a semi-autonomous setup in which some aspects are separate from the physical store operation and some are shared. “The delivery is separate, but via the same mechanism,” says Giger of Fust. “We deliver most products from a central store. There are special businesses which you only can do on the Internet, such as auctions, and if it is a separate thing from the shop it needs to be managed separately. We want to separate it where it makes sense.” Giger also notes that his company has outsourced technology for the Web site and for payment transactions, citing efficiency as the primary reason.

Product mix tends to be the same as in the brick-and-mortar stores or is a subset of the broader assortment. Patrik Fischer, head of IT support for supermarket operator Spar (spar.ch), points out that product mix can vary from one store to another, including the online store. “The online store has a subset of the in-store mix, but with unique products,” says Fischer. “Big stores have a little more product; normal shops have the same or just a little bit more, like the Internet shop.”

To help drive online sales, Swiss e-tailers are relying on a variety of services such as providing additional product information, how-to advice, and other product suggestions, and most say these activities are important to driving online sales. “The customer can check the state of their delivery,” says Hauser. “They can check if goods are in stock and they can get in contact with us through the site for advice.”

Some Swiss e-tailers are establishing a number of alliances in an attempt to drive more traffic to their sites and expand their product offerings without actually building up more inventory. Giger notes that Fust looks for partners that have a similar customer base. “We have a lot of different alliances. For example, if a company sells cooking pans, they might need an oven [which Fust sells],” he says. “We can share the costs and have more purchases. We promote each other.”
Swiss Consumers:
E-Commerce Enthusiasts

Most Swiss consumers who are wired are buying, but many more need to take to the Net if e-commerce is to expand.

The online community in Switzerland has shown a decided commitment to e-commerce. The challenge now is to get more consumers plugged in and connected to the Web. Among Swiss Internet users, almost 73% are buying online, among the highest of the countries researched in this report. PC penetration is strong at 41% of households, but it will have to increase if online buying is to take off. An encouraging sign is that 36% of households have Internet access, which means that once Swiss consumers get a PC, they’re very likely to connect to the Web.

In addition, 98% of Web users indicated that they expect to make a purchase online in the next 12 months. And nearly one-third of Swiss online buyers said that in the past 12 months they had greatly increased the number of items purchased online, compared with a year earlier.

Third of Swiss online buyers said that in the past 12 months they had greatly increased the number of items purchased online, compared with a year earlier. Similarly, 30% of respondents said the value of their Internet purchases had greatly increased over the past year.

While these signs are positive, it’s still early in the game for most Swiss online buyers. Almost three out of five respondents said they had shopped fewer than five sites. And 47% of those who have not previously purchased online have no plans at all to do so in the next year. Those consumers who have hesitated to make online purchases cite three key reasons: First and foremost are concerns about credit card...
security, which was mentioned by 59% of respondents. Second, 45% said they do not have a credit card, and, third, 45% said they preferred to see and feel products before buying. Other issues noted by consumers were a lack of confidence in online merchants and the confusing nature of online shopping.

At this point, Swiss Net shoppers have made an average of almost 11 online purchases in the past 12 months, with 6% indicating that they had made 25 or more separate purchases. The annual total value of these online purchases averaged $734.

Buying beyond the basics

Online buying in Switzerland is still heavily concentrated in the books, CDs, and computer-related products categories, several additional sectors are beginning to make inroads. For instance, 21% of buyers have purchased financial services online; 20% have bought flowers and videos; 16% have bought consumer electronics; 15% have purchased apparel; and 12% have bought food and drink. Other categories, such as car rental reservations, toys, sporting goods, health and beauty, and large household goods, have been bought by no more than 10% of Web shoppers.

Among the five product sectors studied in this report (apparel, consumer electronics, toys, food and beverages, and health and beauty), purchase patterns vary somewhat. Health and beauty and food and beverages are the most frequently purchased items, but only a small percentage of online respondents are actually buying from these categories. The total annual value of online purchases in the sectors spans a wide range, from $86 for toys at the low end, up to $688 for food and beverages at the high end. However, it should be noted that while the total spending for food was high, the median expenditure is only $75. Half or more buyers expect to increase online spending in all categories except consumer electronics, where 44% believe their spending will remain the same and 16% expect it to decrease somewhat.

The U.S. influence on European e-commerce is apparent in the fact that Amazon leads the list of favorite sites, mentioned by 29% of Swiss respondents. However,
The U.S. influence is apparent in the fact that Amazon leads the list of favorite sites, mentioned by 29% of Swiss respondents. However, European sites make up the remainder of the top five.

European sites make up the remainder of the top five, led by Bol, the online operation of German media conglomerate Bertelsmann, named by 17% of buyers; mega retailer Migros, 10%; consumer electronics retailer Interdiscount, 10%; and Swisscom, the country’s telecom giant, 9%.

The majority of Swiss online buyers list item selection and competitive prices as the key reasons for shopping at their favorite sites. In fact, many said they want a combination of the two features. More than three-quarters of online buyers expect sites to have the same products as in the store or catalog, including some online bargains. That’s true across all five product sectors. Respondents consistently said they expect online items to cost less than the same items in the store or catalog.

Web shoppers also have demonstrated a proclivity toward impulse buying, with nearly three-quarters indicating that at least some percentage of their online purchases is unplanned. The majority of impulse buying resulted from seeing products on sale, although roughly one-third of buyers said that a special occasion or an item being highlighted on the Web site could cause them to make an unplanned purchase.

While an increasing number of Swiss consumers are turning to online shopping, it’s too early to judge the impact on brick-and-mortar stores. Among online buyers, 41% said they shop at retail stores less often, and more than half of Swiss online purchases are sales that otherwise would have been made in the store. However, 38% of consumers’ online shopping trips translate into a purchase at a physical store, nearly the same number that result in online purchases. And 52% said they shop physical stores just as often as they shop the Internet.

Satisfaction guaranteed?

What do Swiss shoppers think of their online buying experiences? Satisfaction ratings in the different sectors were all over the board. At the low end in terms of overall experience was the consumer electronics category, where a mere 8% of buyers awarded high marks. A fair number of shoppers gave e-tailers in this sector high scores for product quality, but ratings for selection, pricing, ease of use, and customer service were mediocre at best. Consumers’ dissatisfaction with their
At the other end of the satisfaction spectrum was the toy business, where half or more of buyers awarded high ratings for overall experience, as well as ease of use, product quality, customer service, and pricing. The remaining three sectors fell somewhere in the middle. In the online clothing category, mediocre scores were awarded for overall experience, customer service, product quality, and item selection.

Understanding what Net shoppers don’t like can be equally as important as understanding what they do like. The complaints voiced by Swiss online shoppers are common to Web buyers the world over.

Personal sizing was the leading factor discouraging online purchasing and was cited by 43% of respondents, followed by high prices, named by 35%, and high shipping costs, mentioned by one-third. Despite these complaints, the Web-buying experiences of most respondents have been relatively trouble free. A little more than half said they have experienced no problems related to fulfillment and customer service. And 68% of those who have had difficulties said they will continue to shop online, although 24% said they will no longer purchase from a particular Web site.

Although shoppers complained about high shipping costs, nearly half cited faster shipping as the key improvement they’d like to see in Internet shopping. This was followed by lower prices, total guarantees of security, and lower shipping costs. However, free shipping was the feature most likely to get buyers to visit a site more often.
During the past year e-tailing in the U.K. has been as much subject to the jitters as any of the other major online economies in northern Europe or around the world. But there are positive signs that online retailers are learning the lessons they need to learn in order to survive and prosper. While there have been some high-profile pure-play failures, there are also success stories, along with a growing acknowledgement that the future lies in clicks-and-mortar partnerships and alliances — either between pure-plays and traditional retailers, or traditional retailers combining online offerings with high-street stores.

In effect, online retailing in the U.K. is beginning to undergo a period of transformation. There is increased recognition that profitability predictions fluctuate wildly and are therefore not a good indication of true financial strength or position. Cash-flow forecasts and prudent spending are now the focus of financial assessment. It's generally believed that the businesses with the lowest return rates are those that have the most efficient and cost-effective delivery systems, a good sign for an e-company's future. Retailers doing well in this area include mail-order businesses, which have the benefit of the experience built up during the course of their pre-online days.

The state of play
The online retail environment in the U.K. currently consists of a mix of traditional companies and Web start-ups. For example, a number of airlines, including big players like British Airways as well as smaller, no-frills airlines, now offer ticket services online, as does Expedia.co.uk, the pure-play default travel provider for MSN. Sectors such as software, games, toys, music, books, electrical products, groceries, financial services, and technology products are all well-represented by traditional brick-and-mortar retailers.

By far the biggest online purchase category was CDs and recorded music at 67%. Next comes books at 65%, followed by computers at 53%. An emerging category is apparel, at 28%, followed by food and drink at 23%.

According to our research, the U.K. is the global category leader in online grocery sales. Tesco.com, the online service for the
The gap between gross margins and operating costs will have to close if online businesses are to be viable.

U.K.’s leading grocery chain, receives 60,000 orders a week, with an average value of U.S. $120 per order. The supermarket chain has successfully transferred its in-store values to online consumers, backed up by an excellent delivery system that covers almost all of the U.K. One lesson to be learned from Tesco is that it is critical to deliver products reliably. As in other countries, the U.K. is wrestling to solve what is undoubtedly a complicated problem. A variety of ideas are currently being aired, from out-of-hours delivery (particularly important for same-day delivery of perishable or chilled goods) to “drop bins,” purpose-built collection points, or arrangements with the local Post Office or corner shop.

At the moment, satisfactory delivery of goods remains something of a barrier to online purchasing. Smaller goods can be delivered by post, which may partly account for the dominance of software, CDs, videos, and books in the sales charts. Online retailers clearly recognize this fact, and there is a general realization that the problem will need a variety of solutions in order to cover different delivery criteria.

The U.K. online

Meanwhile, other issues arose in 2000 to occupy the minds of online retailers. During the year PC penetration of U.K. households passed the 40% mark, with the majority of these being Internet-connected. The cost of PCs has fallen dramatically due to intense competition between retailers like Tiny, Time, and Dixons. The main advertising push has been toward families, offering “home entertainment centers” that combine an Internet-connected computer with a games console, DVD, digital camera, scanner…the whole works.

Competition among ISPs to give users either free unlimited access to the Net or unlimited access for a low fixed fee is also growing. The UK communications infrastructure is now deregulated, and competitors of British Telecom can offer Internet services using BT phone lines. This could result in much lower Internet charges. For example, a business like British Gas, which is the traditional supplier of gas to U.K. households, has now added communications to its service offering, undercutting BT’s phone charges with a cheap “pay as you surf” Internet service.

At the same time, the high costs of either starting an online business or maintaining one are reflected in the fact that, even for well-positioned and high-profile businesses, the gap between gross margins and operating costs will have to close if these businesses are to be viable. All of this contributes to a complex and, at times, contradictory picture. On one hand, there has been a significant online retailer shakeout in the U.K. during 2000, on the other hand, there are numerous initiatives aimed at growing cyber-shopping.

Future strategies

So what clues are emerging as to the future of e-commerce in 2001 and beyond? Certainly, the era of business consolidation is getting underway. Alliances between pure-plays, and between pure-plays and traditional retailers, are on the
Alliances between pure-plays, and between pure-plays and traditional retailers, are on the rise.

Competing technologies

Another e-tailer who has realized the value of partnerships in the U.K. is lastminute.com. Not only does the company have excellent distribution agreements; it has more than 100 relationships with different online partners including Freeserve, MSN, and Expedia, as well as marketing partnerships with such organizations as British Airports Authorities (BAA). As part of BAA's strategic investment, they will place lastminute.com's brand name throughout their airports. As Martha Lane Fox, co-founder and director of lastminute.com says, this demonstrates that "we are the best-known e-commerce brand in the U.K."

As for other technologies that pose a threat to the Internet, WAP phones have so far been something of a disappointment, while interactive digital TV (idTV) is only now beginning to be available. Nevertheless, given the simple fact that almost all U.K. households have at least one television, and the power of broadcasters like Sky, the Internet needs to consolidate its position generally in the minds of the purchasing public while extending its multi-channel presence.

Despite these questions, there is nevertheless a strong sense that online purchasing somehow became a fact of life during 2000. The shakeout of online retailers has not brought the industry to its knees, because, quite simply, they provide a consumer need that is set to grow and grow.
U.K. Buyers Take the Online Plunge

UK. consumers are ramping up following a slow start that put them behind several of the world’s e-commerce leaders.

After a slow start that has left the United Kingdom trailing the U.S. in terms of e-commerce development, online buyers are moving fast to close the gap. More than three-quarters of the country’s Web users said they have made an online purchase in the past year, the second highest (behind Germany) of the countries studied in this report. And 86% said they expect to buy online in the next 12 months. That’s the good news.

The bad news is that PC penetration and Internet access levels lag behind countries such as Canada, the Netherlands, the U.S., and Australia. Only 42% of households have PCs, 33% with an Internet connection. Increasing the adoption of the necessary technology will be crucial if the UK is to make up ground on the e-commerce leaders. Additional hurdles stand in the way of greater growth in online buying. Chief among them are the need to see and feel products before purchasing, named by 51% of respondents, and concerns about the use of credit cards online, cited by 49%. In addition, 38% said they don’t have a credit card, clearly a challenge for anyone hoping to engage in e-commerce. Online buyers also said they’d like to see lower prices and lower shipping costs, and a substantial number noted that free shipping would get them to visit sites more often.

What else do U.K. shoppers want from Web merchants? The two key factors are good selection and competitive prices. The majority of respondents expect sites to...
have the same product selection as they do in the store or catalog, along with online bargains. In all product sectors except food and beverages, buyers expect that the online products will cost less than the same items in the store or catalog. In the food category, half of the U.K. buyers expect that prices will be the same. More than one-quarter of respondents indicated that they want more products to be available online than offline.

As e-commerce develops in the U.K., consumers are broadening their usage to include an expanded number of sites and product categories. More than half of those who have made a purchase said they have bought from five or more sites in the past 12 months, and that should continue to increase as buyers’ comfort level grows. On average, they have purchased from seven sites and have made more than 13 online purchases in the last year, with an annual total value of $778 and a median expenditure of $400.

**Buyers branch out**

While CDs, books, and computer products remain the top three categories among U.K. Web shoppers, a significant number of consumers are buying from a variety of other sectors as well. More than one-third have purchased videos; 30% have bought consumer electronics; 28% have bought clothing; and 23% have bought food and beverages. A number of other categories, including toys, flowers, and large household goods, are less developed, with no more than 15% of buyers purchasing products in these areas.

Consumer electronics, clothing, and toys average between two and three annual purchases per consumer, while food and beverages leads with seven purchases. U.K. consumers have shown an increasing willingness to buy food products over the Web, which has become the latest battleground for the U.K.’s highly competitive grocery business. Strong e-initiatives by major players such as Tesco and Iceland are driving this market. Food and beverages also tops the list in terms of annual value of purchases made, at $496. That’s followed by consumer electronics, with an average annual total value of $332 for

**The Web has become the latest battle ground for the U.K.’s highly competitive grocery business.**

### Annual household income of buyers

The chart shows the distribution of annual household income of buyers. The highest income group (over $100,000) has the highest percentage of buyers, while the lowest income group (under $30,000) has the lowest percentage.

### Highest educational level achieved by highest income in household

The chart shows the educational level of those with the highest income in each household. The highest educational level is completed by those with a graduate degree, followed by those with a 4-year college degree. The lowest educational level is completed by those with some college, no degree.
Consumers indicated that they expected to increase their spending in all five sectors. Three-quarters of online buyers in the food and beverage category plan to buy more over the Internet in the next 12 months, perhaps driven by the widening availability of these services. Roughly half of buyers in the other sectors expected their spending to increase.

Satisfaction ratings in the five sectors were mediocre, with no category standing out. In clothing, for example, consumers’ satisfaction with product quality was strong, but the marks were far lower for factors such as overall online shopping experience, special offers, shipping costs, customer service, and item selection. The marks for e-tailers in the consumer electronics sector weren’t much higher. Product quality and pricing were given fairly strong ratings, but other factors scored far lower.

In the toy market, product quality was awarded high marks, followed by pricing and selection. More than one-third of consumers gave the highest satisfaction rating for overall online shopping experience, but the ratings were lower for shipping costs and special offers. Food and beverages, while a growing e-commerce category, did not fare all that well either. The sector received high marks for product quality, mediocre marks for item selection, and quite low ratings for most of the other measures. Similarly, health and beauty sites received good grades for product quality, but the ratings fell off after that.

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In Amazon’s shadow

In terms of favorite sites, there’s Amazon and there’s everybody else. Amazon was the most frequented site, with more than half of buyers listing it at the top of their favorites list. Beyond Amazon, however, there’s very little loyalty on the part of
consumers, as e-tailers struggle to boost their Web presence and brand awareness.

The next site on the list, Jungle.com, a music and electronics e-tailer, was named by just 12% of respondents. Other sites on the favorites list include music e-tailer Audiostreet, named by 11%; Tesco, the high-street grocery chain, 10%; Blackstar, a video/DVD retailer, 10%; U.K.-based auction site QXL, 9%; Easyjet, a low-cost airline with online booking and reservations, 6%; Ticketmaster, 6%; and Buy.com, 6%.

Although a substantial portion of Web users are buying online, their shopping trips aren’t always successful. Fewer than half of their online trips actually result in a purchase being made over the Web. In nearly one-third of the cases, no purchase is made at all, and 19% of the trips result in a purchase at a retail store. Nevertheless, almost two-thirds of online buyers said they shop at retail stores less often than they did previously. Furthermore, two-thirds of online purchases are sales that otherwise would have been made in-store.

In terms of favorite sites, there’s Amazon and there’s everybody else. More than half of buyers listed Amazon at the top of their favorites list.

What do U.K. consumers dislike about Web shopping? Personal sizing is the biggest complaint, with shipping costs second. Despite these issues, half of respondents said they had experienced no problems related to fulfillment and customer service. And most of those who have had difficulties said that won’t stop them from buying on the Internet. Although a substantial portion of Web users are buying online, their shopping trips aren’t always successful. Fewer than half of their online trips actually result in a purchase being made over the Web. In nearly one-third of the cases, no purchase is made at all, and 19% of the trips result in a purchase at a retail store. Nevertheless, almost two-thirds of online buyers said they shop at retail stores less often than they did previously. Furthermore, two-thirds of online purchases are sales that otherwise would have been made in-store.

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U.S. E-Tailing Enters a New Phase

The United States remains the leader of the e-commerce pack, but moderating growth is forcing e-tailers to take a closer look at integration strategies, product assortment, pricing structures, and consumer issues.

By Jay McIntosh, Director, Retail & Consumer Products, U.S.

The United States is by far the global leader in the B2C e-commerce arena. Yet it faces its share of challenges as consumers become increasingly demanding, venture capital is more scarce, and the investment community is focused more on bottom-line profits than top-line sales.

There is no question that the e-commerce business in the U.S. has developed significantly over the past year, thanks to strong usage by consumers, who are wired and buying. According to International Data Corporation (IDC), 53% of U.S. households have PCs, 41% with Internet access. And 17% of the population has shopped online from home.

But as growth begins to moderate, e-business strategies are being examined more closely, and questions are being asked. How can companies integrate the store channel with the online channel? How do they drive customers to the site and convert them to loyal buyers? How do they meet and exceed customer expectations?

There’s some evidence of a disconnect between retailers and consumers regarding why consumers visit particular sites. Retailers point to factors such as convenience, trust/name recognition, and customer service as the most important reasons, while consumers list product selection and competitive prices as the factors that matter most to them. Clearly, ironing out these disconnects will be crucial for e-commerce to continue to grow in the U.S.

Dot-com setbacks

The U.S. e-tailing world is also grappling with the setbacks suffered in the pure-play world. Sectors such as pet products and groceries were particularly hard-hit, with numerous dot-com players falling by the wayside. In the pet supplies category, Pets.com shut down in the fall, unable to raise additional financing. Its demise came despite backing by Amazon and the fact that it claimed 570,000 customers.

Similarly, MotherNature.com, a popular natural product health site, also fell victim to the dot-com shakeout. In the U.S. online grocery business, pure-plays littered the landscape. Streamline and ShopLink shut down this past fall, and Peapod barely escaped a similar fate earlier in the year, saved at the eleventh hour by Ahold, the Dutch-based retailing giant that purchased a controlling interest in the online grocer.

As the market develops, U.S. e-tailers of all types face an array of challenges, including customer service and satisfaction, the importance of having an excellent
E-tailing strategies in the U.S. lean toward integrated and semi-autonomous business models rather than fully autonomous operations.

e-infrastructure in place, integration issues, and fulfillment. Mark Staudinger, vice president of interactive media for Eddie Bauer, points to the challenge of shifting from technology issues to an end-to-end focus on the customer. “The first shoppers were techno-savvy, but now customers are mainstream consumers,” says Staudinger. “That means the site has to be easy to use, convenient, and efficient.”

Integration issues
An important management issue being explored in the U.S. is: Should an online division be integrated into the company’s core business, or managed as a separate operating entity? E-tailing strategies in the U.S. lean toward integrated and semi-autonomous business models rather than fully autonomous operations. But again, there are differences, depending on the type of retailer. Traditional companies like JCPenney and Staples are likely to have a semi-autonomous business model for their online operation, whereas the vast majority of catalog retailers like Crutchfield fully integrate their online business into their core operation. Brand suppliers such as Panasonic, on the other hand, are split evenly between full integration and a semi-autonomous strategy. The choice of e-strategy is reflected in the company’s management approach. Among firms with either a partially or wholly autonomous e-commerce operation, 90% have a separate management staff for their online unit, according to Ernst & Young’s research.

How do you measure success in the e-tail world? Revenue and profitability represent the most significant metrics for U.S. retail e-commerce sites overall. However, catalog-based retailers are more likely to cite customer acquisition costs, a carryover from their catalog business. Conversion rates are a key metric for all companies as they attempt to turn eyeballs into dollars.

All U.S. catalog retailers interviewed use the same pricing strategy for their online stores. Conversely, 60% of traditional retailers have established a different pricing structure for their online operation. Some of the differences in pricing practices include different markdown schedules for merchandise carried in-store and online, online purchasing incentives, or one-day, store-only shopping specials.

“The stores and the online site are not on the same promotional calendar,” says Jim Sluzewski, spokesman for Macy’s.com, operated by Federated Department Stores. “Something may go on sale in the store, but it may not apply to the online store. People shop the site for convenience, not as much for price, so it is less of an issue.”

What does the future look like for e-commerce in the U.S.? While growth will continue, there will be a gradual slowdown in that rate. One barrier to continued growth in the B2C arena is the digital divide — that is, the gap between the technology haves and have-nots. According to a report by the U.S. Department of Commerce, households with incomes of $75,000 and higher are more than 20 times more likely to have access to the Internet than those at the lowest income levels. The government has begun to address the issue through a variety of initiatives and has launched a Web site (digitaldivide.gov) to address the topic.
The number of Internet purchases made by U.S. consumers is second to the U.K., averaging 13 in the past year. And three-quarters of online buyers reported an increase in the number of items purchased online. Online buyers in the U.S. spent, on average, $896 last year shopping on the Net, and three-quarters also increased the value of their online spending in the past 12 months.

There’s no question that online shopping is beginning to have an impact on physical stores. And that fact can be viewed as either good news or bad news for retailers, depending on their degree of e-commerce readiness. Among online buyers, 57% said they shop at retail stores less often, while only 4% said online shopping has caused them to shop at physical stores more often. In addition, 59% reported that their online purchases would have otherwise been made in-store or in a catalog.

Consumer purchasing “broadens”

Books, CDs/recorded music and computer products continue to lead the online shop-
ping list, having been purchased by about half of online buyers in the past 12 months. However, consumers’ Internet purchases are spanning an ever-widening range of product categories. For instance, apparel is becoming an increasingly popular purchase for Net shoppers, with 37% having made online clothing purchases. Among Web buyers, 25% to 28% have bought consumer electronics, toys, videos, and health and beauty items online in the past 12 months. After the top categories, there is a sharp drop-off in the percentage of buyers having purchased from any category.

Amazon.com and Barnes & Noble continue to lead the list of most-frequented sites, with 28% and 15% of U.S. online buyers, respectively, listing these as one of their top three favorite sites. Traditional retailers are emerging, however. Following behind Amazon and Barnes & Noble are eBay (named by 9% of respondents), JC Penney (7%), CDnow (7%), Buy.com (7%), Drugstore.com (6%), Fingerhut (6%), and eToys (6%).

What brings consumers to these sites? The majority of U.S. online buyers list “good selection of items” and “competitive prices” as the key reasons for shopping at their favorite sites. For brick-and-mortar and catalog retailers, offering the same items both online and in their stores or catalogs is important to shoppers, something that most catalog retailers, but not all physical-store operators, are inclined to do. Almost three-quarters of online buyers said they expect the online site to have the same products as the store or catalog, and 51% expect these to include online bargains. While respondents cite “competitive prices” as important, they are also looking for low prices. Across all the categories studied — clothing, consumer electronics, toys, foods and beverages, and health and beauty — respondents consistently expect that online items will cost less than the same items in the store or catalog. Critical to any e-tailer’s strategy will be an understanding of these perceptions among Internet shoppers.

Close-up on categories
A closer look at these segments provides a more detailed picture of what’s happening in the world of Web shopping. The average number of annual purchases in the clothing, food and beverage, health and beauty, and toy sectors ranges from four to five. However, the number for consumer electronics is just two, not surprising given that these items are typically longer lasting.

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and more expensive than products in the other sectors. The annual value of online consumer electronics purchases was $263, compared with $236 for clothing, $197 for food and beverages, $168 for toys, and $138 for health and beauty products. These numbers should increase over the next year, since the vast majority of online buyers expect to spend the same or more in these categories.

The increase in online buying in the apparel sector seems to indicate that consumers are becoming increasingly comfortable buying clothes without trying them on, despite the fact that personal sizing remains a key deterrent for some shoppers. While the average number of annual online clothing purchases was four, almost one-quarter of shoppers made five or more apparel purchase over the Net in the past 12 months. And 55% of consumers expect the value of those purchases to increase.

What did Web buyers think of their apparel shopping experience? Only one-third gave the highest satisfaction rating for overall online shopping experience, but Web sites were given good marks for quality and ease of use.

In the consumer electronics area, a significant number of consumers also expect to increase the value of their online purchases over the next year. Satisfaction levels were somewhat higher in this sector than in apparel, with 41% of U.S. online buyers giving the highest rating for their overall online shopping experience. These e-tailers also did well in areas such as online item selection, price, ease of use, and product quality.

The toy category shows strong potential for growth. Almost one-third of buyers said they had made more than five online toy purchases in the past year, and 55% expect the value of these purchases to increase in the coming 12 months. Clearly, they like what they’re getting when it comes to their toy-buying experience. Half of toy buyers gave the highest satisfaction rating for their overall online shopping experience. In addition, they rated sites highly on price, selection, ease of use, and product quality.

Satisfaction levels were also fairly high in the food and beverages sector, with 44% of buyers giving the highest rating for their overall experience. Significantly, 64% of online buyers gave food and beverage sellers the highest satisfaction rating for product quality. Sites also got good grades for selection, customer service and ease of use.
The online health and beauty sector shines in many respects. More than 60% of online buyers said they expect to increase the value of their health and beauty purchases over the Web in the next year, and also report a positive shopping experience. Half of health and beauty buyers gave the highest rating for their overall online experience. In addition, 60% awarded top grades for product quality and 54% gave the highest rating for ease of use. Health and beauty etailers also did well in areas such as price, selection, special offers, and customer service.

Barriers to buying
While many U.S. consumers have become increasingly comfortable shopping the Web, there remain plenty who have steered clear. Not having a credit card or distrust of using a credit card online are the leading obstacles to greater online purchasing. More than half of respondents said the fact that they do not have a credit card was the primary reason for not expecting to purchase online in the next year, while 48% said they were uncomfortable using a credit card online.

Credit card issues aren’t the only deterrent to Web buying. Shipping costs are cited as the primary factor discouraging online purchases, followed by personal sizing and the high cost of an item. High shipping costs are also the number-one reason for abandoned shopping carts. The frequency of shopping cart abandonment is high, at 75%, with 45% saying that high shipping costs are the primary cause.

What will it take to drive continued online shopping growth? Web buyers said that lower shipping costs and lower prices are the leading improvements they’d like to see. Free shipping is most often cited as the factor that would get them to visit Web sites more often. Among online buyers, 57% pointed to free shipping, with discount coupons second but cited by just 17% of respondents.

While consumers are likely to continue to complain about shipping costs, they are far more satisfied with other aspects of the online shopping experience, which is good news for U.S. etailers. Half of U.S. online shoppers said they have experienced no problems related to fulfillment and customer service. And 71% of those who have had problems said it will have little or no effect on their online shopping, although 24% will no longer purchase from a particular Web site.
Leveraging its strengths in e-business and drawing upon its deep knowledge of the retail and consumer products industry, Ernst & Young has developed a dedicated capability in assisting retail and consumer products companies develop and execute multi-channel strategies to sell directly to customers. It is led by Stephanie Shern, Global Director of Retail and Consumer Products.

Ernst & Young, a global leader in professional services and the financial services industry, helps clients to quickly and confidently make financial decisions designed to enhance value. Its 77,000 people in more than 130 countries have the industry and financial experience to provide fresh perspectives on operating in the new economy. Ernst & Young offers broad-based specialized accounting, audit, and tax services, as well as customized services in corporate finance, online security risk management and regulatory advisory services, the valuation of intangibles and e-business acceleration. In addition, legal services are available in various parts of the world where permitted. A collection of Ernst & Young’s latest ideas on the new economy can be found at www.ey.com/thoughtcenter.

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