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Order management for profit on the Internet☆

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Abstract To succeed, Internet retailers must make a profit on the goods and services they sell. But e-tailers are still searching for strategies that work. To test current practices, we became "phantom shoppers" and bought a randomly chosen set of CDs from a variety of Internet retailers. Our findings suggest that order management and logistics skills are pivotal for selling profitably on the Internet. In this article, we show how Internet retailers can deploy resources creatively to attract the right shoppers, convert these shoppers into buyers, and improve the chances of repeat purchase while maintaining profit margins.

1. Introduction

Internet retailers have been remarkably successful in attracting visitors and shoppers to their sites. Despite the economic downturn in the U.S., Internet retail sales increased 48% from 2001 to 2002, with preliminary data indicating another 30% increase for 2003. Recent surveys find that online purchases account for 32% of dollars spent on computer hardware and software, 17% of event ticket sales, and 12% of book expenditures. The Internet's importance as a retail channel is no longer in dispute; online sales will continue to grow and are one of the brightest spots in a recovering retail industry.

Internet retailers are also starting to show positive returns. In 2002, 70% of large Internet retailers claimed to be profitable before interest and special charges, and leading industry players such as Amazon.com are headed toward consistent profitability. More and more, stockholders in these firms are debating not whether profits will be realized but when and how much.

What strategies lead to profits from Internet sales? Many first movers seized on the obvious characteristics of the Internet: minimal search and low transaction costs. These pioneers concluded that low prices and high volumes would result in consistent profits. With essentially zero selling cost, any revenue, however small, must go to the bottom line. Many of these firms, such as

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Boo.com and Webvan, are no longer in existence, while other firms thought through all of the Internet's implications and thrived. Some of these businesses operate solely on line, the so-called "Pure-Play" Internet retailers. Alternatively, established retailers also started Internet sales sites, converting themselves into "Brick-and-Click" merchants.

To sort out the implications of these strategies, we needed to understand how Internet retailing really works, so we became "phantom shoppers" and executed over 250 purchases of music compact discs (CDs) from a variety of leading Internet music retailers. We recorded the price we paid, the service we received, and the information available from each Web site. We also recorded the retailer's cost for each CD based on information from the wholesaler that filled our orders, using its own inventory. We then computed the retailer's margin by subtracting the retailer's cost from the price we paid.

In summary, we were able to get complete information on prices, costs, margins, and service for over 250 Internet retail purchases. This rich set of data allowed us to model the relationship between transaction margins, retailer-provided information, and order fulfillment for both Pure-Play and Brick-and-Click Internet retailers. It turns out that profitable electronic retailers design their product and service offerings to (see Fig. 1):

(a) attract visitors to their sites with excellent connectivity and cross-marketing and preempt competitors from using low prices to maximize market share and revenues;
(b) convert visitors into customers through attractive inventory selection and product information, allowing retailers to offset competitor prices through a superior ordering experience; and
(c) retain customers with fulfillment services that match compelling performance promises.

Successful Internet retailers apply resources selectively to maximize the chance of a profitable sale. Supply chain execution is critical because delivery as promised turns out to be an important part of the quest for positive profit margins.

2. Task 1: Attracting potential customers

To make a sale, Internet retailers must persuade consumers to visit their web sites. Effective marketing communication is the key, adapted for the ubiquitous connectivity of the Internet. In an electronic world, the ideal is to be "top of mind" or, even better, "top of search engine". Hence, the huge sums of money some Internet retailers have devoted to offline advertising and the intensity of their efforts to get listed in and linked to the most popular search-engine and complementary-partner sites on the Internet. Internet retailers have to develop name recognition and a presence in cyberspace to match the branding power of merchants who have visibility on and off the Internet. It is no accident that the most profitable dotcom players such as Amazon.com, Yahoo, and Google are now household names; they have used both online and offline marketing tools to become the automatic choice of Internet shoppers.

3. Task 2: Convert visitors to buyers

Once at a site, visitors have to find the product they want at an acceptable price, and research has shown that selection is at least as critical as cost. Internet shoppers tend to stick with the

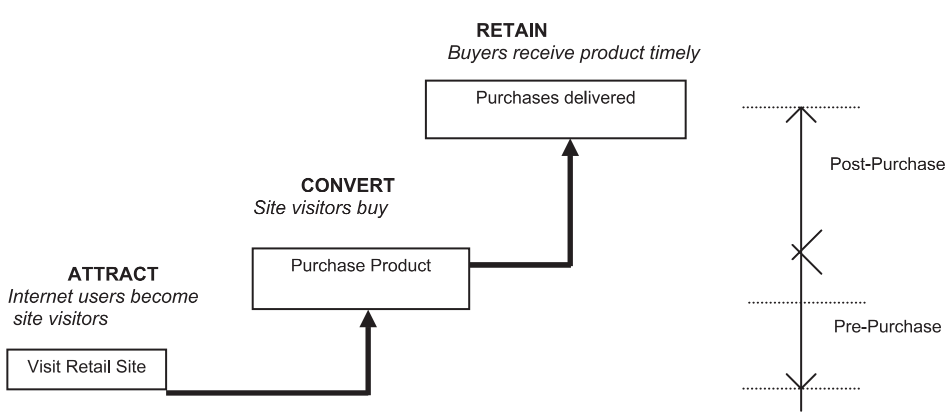

Figure 1 Order management stages in Internet retailing.