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PRICING AND BRANDING ON THE INTERNET

It's a great time to be a consumer. You have more power than you could possibly imagine.[1]

Kate Delhagen, Forrester Research

In Internet retailing, abundant information, reduced transaction costs, and unlimited "shelf space" promise to increase the consumer's purchasing power. Online buyers expect the Web to be an around-the-clock fire sale, with the next bargain just a click away. This "getting a deal" culture is pervasive among Internet shoppers. According to a recent survey, more than half of online shoppers expect a 20-30 percent discount from the standard retail price when buying an item that would normally be priced between $30 and $500.[2] "If you're a consumer and you're thinking about any kind of researched purchase, you're leaving thousands of dollars on the table if you don't at least look online" says Kate Delhagen, an online retail analyst with Forrester Research.

Low consumer search costs, the financial markets' tolerance for aggressive spending on customer acquisition, and the Internet's lower entry and operational costs cause many to expect that competition will intensify. Prices will decline and brand loyalty will be threatened as both Internet start-ups and traditional retailers try to acquire and retain customers. At the limit, intense competition and perfectly informed consumers will drive prices down to marginal cost.

Empirical evidence on the impact of the Internet on pricing and branding has been mixed. MIT's Sloan School of Management studied pricing for books and CDs. On the one hand, the results showed that Internet prices average 9-16% less than conventional channel prices.[3] On the other hand, however, price dispersion on the Internet may suggest that search costs are not minimal or that factors other than price influence consumers' decisions. The same study by MIT concluded, "...there are substantial and systematic differences in prices across retailers on the Internet. Prices

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[1] David Bank, "A Site-Eat-Site World," Wall Street Journal, July 12, 1999, p. R8
[2] Bob Tedeschi, "Using Discounts to Build a Client Base," http://www.nytimes.com, May 31, 1999
[3] Erik Brynjolfsson and Michael D. Smith, "Frictionless Commerce? A comparison of Internet and conventional retailers," http://ccs.mit.edu/erik, May 1999

Research Associate Kostas Sgoutas, MBA 2000, prepared this case under the supervision of Professor Garth Saloner and Professor A. Michael Spence as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Margot Sutherland, Executive Director, Center for Electronic Business and Commerce, Graduate School of Business managed the development of the case. Research support by the Boston Consulting Group is gratefully acknowledged.

posted on the Internet differ by an average of 33% for books and 25% for CDs (Exhibit 1). At the same time, the dispersion of prices weighted by retailer popularity reveals that Internet markets are highly concentrated, but the retailers with the lowest prices do not receive the most sales."[4] Bizrate.com's survey of online buyers also suggests that product price is the attribute least correlated with a repeat online purchase. Instead, customer service, fulfillment, and trust appear to be more important drivers of online loyalty.

The issue of brand evolution is as controversial as pricing. Some experts argue that brands will be even more important in the online world. Their view of increased brand significance is an ally to the Internet efforts of established "brick and mortar" brands. Others believe that increased information will make brands, at least the way they are defined today, less important in the face of increased information availability. John Hagel and Marc Singer, for example, argue that product-centric brands are a proxy for imperfect information and limited shelf space.[5] As the Internet lifts these constraints, information-centric brands that focus on understanding and satisfying consumer needs will replace them. The Internet will therefore give rise to new types of intermediaries, companies that advocate consumers' needs and facilitate transactions by efficiently matching buyers and sellers. Intelligent agents are one example of such intermediaries.

Intermediaries and other retailers are experimenting with different efforts to grow: regular auctions, reverse auctions, group buying, aggressive marketing campaigns and price leadership, for example. Which models will be sustainable as more products are sold on the Internet and more people go online is unclear.

AMAZON.COM

Amazon.com has grown from a small online bookseller in 1995 into the Internet's most powerful merchant. Few doubt that Amazon.com has accelerated, if not caused, the rapid adoption of the Internet as a medium of commerce. Besides books, Amazon offers videos, music, auctions, gifts, electronic greeting cards, consumer electronics, toys, software, video games, and home improvement and gift ideas. In September 1999 Amazon introduced zShops, a storefront-hosting product. Amazon has also invested in other e-commerce merchants such as Drugstore.com, HomeGrocer.com, and Pets.com. In the third quarter of 1999, revenue rose to $355.8 million from $153.6 million, for the corresponding quarter of 1998 and Amazon's registered user base exceeded 13 million. More than 70% of sales were to repeat users. This repeat purchase rate was nearly double the industry average (Exhibit 2).

So far, no one has duplicated Amazon's success. According to Amazon CEO Jeff Bezos, "The most important thing we have that's hard to duplicate is our culture of customer obsession. It pervades customer service, logistics, software and marketing. Companies' cultures are impossible to copy. They're like little starter pieces of sourdough. Either you've got them or you don't. Once a company has a culture, it's like quick-drying cement. You can't just send someone to a customer-focus class for six weeks and expect results."[6] Bezos also explained why this culture of customer obsession is vital in the online environment: "Customer, customer, customer. I think everything falls out of that. It's especially true online, because the balance of power shifts away from the company and toward the customer. Customers have a bigger voice online. If we

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[4] Erik Brynjolfsson and Michael D. Smith, "Frictionless Commerce? A comparison of Internet and conventional retailers," http://ccs.mit.edu/erik, May 1999

[5] John Hagel III and Marc Singer, Net Worth (Boston: Harvard Business Scholl Press, 1999)

[6] George Anders, "The View from the Top," Wall Street Journal, July 12, 1999, p. R52

make a customer unhappy, they can tell thousands of people. Likewise, if you make a customer happy, they can also tell thousands of people. With that kind of a megaphone in the hands of every individual consumer, you had better be a customer-centric company."[7]

Bezos argues that personalization through extensive interaction with customers will drive loyalty to Amazon. "It's just like in traditional retail. If a small-town merchant knew your tastes, he could tell you if something interesting came in and he suspected you might want it. That was very valuable. If there was another merchant who opened up next door and didn't have five years of experience with you, then you wouldn't have as good a shopping experience there, just because the person didn't know you as well."[8] Personalization at Amazon.com is still relatively unsophisticated. In addition to past purchases and searches, variables in its personalization algorithms include demographics and purchase patterns in different product categories and across similar customer groups. The ultimate objective is to give each customer his/her own, unique storefront.

Amazon has been relatively successful in translating its customer focus and aggressive marketing spending (approximately 22 cents per dollar of revenue) into a strong consumer brand. In a Harris Interactive poll, online customers cited Amazon's brand twice as often as Barnes & Noble. "It's not that there is no meaning behind Amazon.com, it's that there are multiple meanings to people," says Christopher Ireland, Principal of Cheskin Research.[9] "To you it might be the biggest bookstore, to me it may be the best place to sample music or to sell antiques. It's not the traditional way to communicate a brand." No traditional retailer enjoys this constant evolution and dynamic definition of Amazon's brand. Traditional retailers think long and hard before changing anything for fear of eroding brand value. According to Nick Shore, a co-founder of brand agency NickandPaul, "Amazon is saying, 'we're not a book brand, we're a convenience brand with books, music, auctions, video.' They are locking into a higher need state, we'll see more of that, and it's part Internet-fueled. They realize their competitive set is not just other bookstores. They can go anywhere."[10]

As Exhibit 1 shows, Amazon.com has been able to leverage its brand recognition and consumer trust to extract a premium over most of its competitors. Three of the eight online book retailers in the MIT study have lower prices, on average, than Amazon.com [11]. The lowest priced retailer, Books.com, has prices that average $1.60 less than Amazon's prices and are lower than Amazon's price 99% of the time. Yet Books.com has only about 2% of the online book market versus Amazon's more than 80%. A recent McKinsey & Co. survey found that 80 percent of online shoppers do not compare prices before buying. "It is very counterintuitive, but so far the trend among customers has been not to compare prices," said John Hagel, who leads the e-commerce practice for McKinsey. "Customers tend to settle quickly on one site in a given category. Once people learn how to get around a site and have a positive experience, they tend to go back"[12] According to Hagel, that's partly because most popular items now selling on the Web are low-ticket goods like books and CDs, that do not reward for price comparison. Moreover, price-comparison technology is still unsophisticated.[13]

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[7] James Daly, "Running Scared," Business 2.0, April 1999, p. 66
[8] George Anders, "The View from the Top," Wall Street Journal, July 12, 1999, p. R52
[9] Becky Ebenkamp, "We're All Brands Around Here," http://www.brandweek.com, June 21, 1999
[10] Ibid.
[11] Erik Brynjolfsson and Michael D. Smith, "Frictionless Commerce? A comparison of Internet and conventional retailers," http://ccs.mit.edu/erik, May 1999
[12] Bob Tedeschi, "Using Discounts to Build a Client Base," http://www.nytimes.com, May 31, 1999
[13] Ibid.

While Amazon currently can afford to charge a premium, change is in the offing. A recent *Wall Street Journal* article discussed how Amazon executives have watched in dismay as online shoppers used Amazon's site's easy-to-use format, in-depth reviews, and expert recommendations, and then made purchases at sites such as Buy.com at even lower prices.[14]

Despite soaring revenues, strong brand recognition, and evidence of premium extraction, losses for Amazon have also been widening. The third quarter loss in 1999 grew to $197 million from $45.2 million a year earlier, though Amazon expects its books division to be profitable in the fourth quarter of 1999. Analysts expect Amazon to begin breaking down overall performance by division to show profitability for its more mature businesses. This may make investors feel more comfortable about the long-term prospects of Amazon's stock. Yet on October 31, 1999 Amazon's stock traded at $70.6 nearly 40% lower than the company's high of 110.6 in the previous 52 weeks.

Bezos does not seem concerned. When discussing a short period of profitability in late 1995, Bezos said that any reasonable management team should have been punished for that: "I believe that if we're investing in something and it works, then we should invest more. Profitability is important to us, but it's long-term profitability that's important, not short-term profitability. I don't want to leave anyone with the impression that we don't care about it. But if what you're trying to optimize for is long-term success, then that causes you to make different decisions in the short term. It would be a mistake to optimize for profitability in the short term, because that would mean you weren't investing aggressively in the things that were working and the things that we really, really believe in."[15]

Amazon has pursued an aggressive growth strategy. "We hope to offer hundreds of additional market opportunities in the next few years" said Bezos. But increased spending to promote the Web site, investing in other companies, expanding distribution capacity, and adding new products have widened Amazon's losses. Amazon's horizontal expansion has raised mixed reactions. "They're trying to broaden the franchise to be preemptive and be the one-stop e-commerce shop – and that costs money," Bill McVail, analyst at Turner Investment Partner told Bloomberg. "But if e-commerce continues to grow the way we believe it will, Amazon is going to benefit."[16] For Barry Par, director of Internet and e-commerce at International Data Corporation, Amazon has to expand. "The market is demanding it. Amazon's market cap wouldn't make any sense if they were only selling books."[17]Yet, analysts warn that Amazon risks major losses if it dilutes its brand identity by spreading itself too thin as it expands. "Amazon moves into music and videos and gifts and other things, [yet] they have to make sure they are still specialists at books," said Jupiter's Michael May. "Otherwise, they are likely to lose the customers who were primarily and largely attracted to their book business. Amazon will find Barnesandnoble.com and Borders.com willing competitors."[18]

David Cooperstein of Forrester Research identified three additional challenges that could potentially damage Amazon's customer-centric brand as it expands.[19] First, customer service will become woefully complex and require more customer service time as Amazon starts selling more

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[14] David Bank, "A Site-Eat-Site World," Wall Street Journal, July 12, 1999, p. R8
[15] James Daly, "Running Scared," Business 2.0, April 1999, p. 66
[16] Tim Clark, "Amazon shares ink on earnings news," CNET News.com , July 22, 1999
[17] S. Junnarkar and T. Wolverton, "Specialty e-tailers risk dilution in growth," CNET News.com , July 12, 1999
[18] Ibid.
[19] David M. Cooperstein. "Amazon.com Attacks Wal-Mart," The Forrester Brief, July 13, 1999

complex products such as DVDs and VCRs. Second, as customers use one-click shopping across categories, Amazon will need to efficiently link seven distribution centers to ensure a single delivery and a seamless customer experience. Finally, Amazon will need to create rigorous product reviews for items such as consumer electronics to remain the leader in product information richness.

As Amazon expands horizontally, it finds itself in the ironic position of investing heavily in brick-and-mortar warehouses. Yet despite some analysts' recommendations, it has not yet revealed an offline consumer strategy. Editors of *Red Herring* magazine encouraged Jeff Bezos to get "real". "An Internet-only business model leaves Amazon.com mired in the past as traditional retailing continues to evolve. Retailers must interact with customers through any channel those customers desire, whether online, face-to-face, through the mail, or over the phone, and they must accept multiple forms of payment - cash, credit, check, debit card, and various forms of electronic payment systems. Not only are retail systems changing, but so are the products themselves. Already, electronic books that hold content downloaded from the Internet are available. Bookstores could be transformed into veritable jukeboxes of CD-ROMs that contain thousands of titles. The books themselves could be printed and bound, on demand, for consumers. An Internet-only business could not exploit these opportunities." [20]

Wal-Mart's expected re-launch of its commerce site prompted the analysts' recommendations for an offline strategy. "Lacking an offline presence," Cooperstein says, "Amazon and other pure-plays will have a hard time reaching the majority of American shoppers who are not online. Meanwhile, Wal-Mart has the opportunity to cross market its nearly ubiquitous stores with its Web site."[21] Clay Ryder of Zona Research agrees: "If Wal-Mart starts selling everything it has in the stores online, it could become the premier online retailer."[22]

Bezos believes that offline and online environments need to be optimized differently. "If you are going to build a company that supports a chain of 1,000 stores, you need an extremely hierarchical culture. You need the store environments to be identical. The last thing you want is creativity on the part of a store manager – who is trying to set his own prices or change the signage and decor. That's a disaster. So the successful companies have avoided having creativity at that level. That's antithetical with developing an Internet company from the ground up for speed of response. With 1,000 stores, you don't want speed of response. If you make mistakes, it's expensive. But on the Internet, you can change the look of your Web site, and if people don't like it, you can change it back in a day. You really do want to optimize differently for the two different environments."[23]

Auctions are an interesting area of Amazon expansion. While Bezos believes in the efficiency of non-negotiable, fixed prices for commodity products, he thinks that auction pricing is suitable for unique items or for items where the price changes rapidly. But he also believes that auctions will be an important part of Amazon's future because the "referral business" as Bezos calls it, will permit Amazon to sell products it doesn't need to stock. "If our goal is to have the earth's biggest selection," he says, "you have to realize that you can't carry and sell directly all those items yourself. It's impractical."[24]

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[20] Red Herring Editors, "Open letter: get real," Red Herring, September 1999, p. 114
[21] Troy Wolverton, "Look out Amazon, Wal-Mart's coming," CNET News.com, July 12, 1999
[22] Ibid.
[23] George Anders, "The View from the Top," Wall Street Journal, July 12, 1999, p. R52
[24] The Industry Standard Editors, "Taking on Wal-Mart," The Industry Standard, June 28, 1999

Lauren Cooks Levitan, an analyst at Banc-Boston Robertson Stephens, says Amazon wants to become the first "e-tail portal, which means standing in the middle of every transaction on the Web." The company plans to accrue "fat margins in the form of lead fees" from commerce sites linked to Amazon.[25] To grow through a referral model, Amazon has acquired Junglee, a price comparison engine, and Alexa, which is well known for its browser integrated technology that generates a dynamic list of related web sites while users surf the web. These acquisitions helped Amazon launch zBubbles and zShops. zBubbles provides both consumer product reviews and information on where to find the best prices. The company's entry into the market for cross-site price comparisons is a response to intelligent agents such as mySimon that threaten Amazon's brand building efforts. With zShops, Amazon's storefront hosting product, small and large merchants can sell their products on Amazon.com. In exchange, Amazon receives a small fee and a cut from transactions. Merchants will gain access to Amazon's 13 million users, and Amazon will gather information on the buying habits of consumers.

BARNES & NOBLE

The bricks-and-mortar bookseller Barnes & Noble launched Barnesandnoble.com in May 1997 as its Internet arm. Two years later, Barnesandnoble.com was spun off, with Barnes & Noble and the international media corporation Bertelsmann each owning approximately 40 percent of the company. The company went public in May 1999, raising $421.6 million, the largest Internet IPO at the time. Priced at $18 per share, the stock traded as high as $26.63before retreating more recently to its offering price. On October 30, 1999 Barnesandnoble.com's market cap of $529.3 million was 50 times lower than Amazon's.[26]

Media Metrix ranked barnesandnoble.com as the fourth largest e-commerce site in June 1999. Barnesandnoble.com sells books, magazines, CDs, videos, and software and opened an online music store in July 1999. Ben Boyd, a company spokesman, said that it plans to focus on products that can be digitized. "We understand the bandwidth of our brand and we won't go beyond that," Boyd said. "We're not going to sell pet food."[27]

Revenues for the third quarter of 1999 were $49.1 million compared to $15.6 million for the same quarter in 1998. Barnesandnoble.com posted a $21.9 million loss compared with $18.6 million a year earlier. Customer accounts increased to over 2.9 million. During the quarter, repeat customer orders increased to more than 63 percent of orders. "All of our key metrics exceeded expectations, illustrating the growing momentum of our business," said Barnesandnoble.com chief executive Jonathan Buckley following their second quarter announcements.[28]

Other business leaders and e-commerce analysts share Buckley's optimism for the successful adoption of the Internet by established brands. Lou Gerstner, IBM's CEO, described the new "dot-com" companies as "fireflies before the storm – all stirred up, throwing off sparks." But he continued, "The storm that's arriving – the real disturbance in the force – is when the thousands

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[25] Ibid.

[26] In late 1999 a patent dispute case about one-click shopping strained the relationship between Amazon and Barnesandnoble. In December 1999, a federal district judge in Seattle granted Amazon.com a preliminary injunction, barring barnesandnoble.com from using a one-click system for online orders.

[27] S. Junnarkar and T. Wolverton, "Specialty e-tailers risk dilution in growth," CNET News.com , July 12, 1999

[28] Sandeep Junnarkar, "Barnesandnoble.com revenues soar," CNET News.com, July 22, 1999

and thousands of institutions that exist today seize the power of this global computing and communications infrastructure and use it to transform themselves. That's the real revolution."[29]

Brand recognition is arguably the most powerful competitive advantage that traditional retailers such as Barnesandnoble.com have against their Internet-only competitors. While e-commerce has made huge strides in recent years, online consumers are still oblivious to most online brands. According to a Harris Interactive poll, 40 percent of online consumers cannot name an online retailer in 12 of 13 categories.[30] As traditional retailers expand online and the Internet population's demographics come closer to the national average, the long-term prospects for Internet-only retailers come into question. In their letter to Jeff Bezos, Red Herring's editors said: "Look no further than your chief competitor, Barnes & Noble, to see just how valuable a real-world brand can be. During the past two years, the very period you were meant to be "disintermediating" offline business, Barnes & Noble's annual revenues topped $3 billion, and its net income rose 73.7 percent to $92.4 million. And Barnesandnoble.com, the company's online venture, will only help the company's brand, inventory, distribution systems, and physical presence."[31]

The trust a strong brand inspires increases in the online environment. In addition to trusting that retailers will deliver the promised service or product, Internet users are also concerned about their privacy and security. As Internet retailers know more than ever about consumer behavior through both information that consumers volunteer and tracking with cookies, online users want to make sure that retailers do not misuse the information collected about them. Whether traditional brands will enjoy a "trust" advantage over Internet-only companies remains unclear.

Barnes & Noble was reluctant to expand in the online environment. It formed Barnesandnoble.com more than two years after Amazon.com started selling books. The huge negative implications of a possible misstep partly explain this delay. "Its very difficult for these companies to think of spending an inordinate amount of money on a cyberstrategy that will ultimately reduce their margins," argues Jerry Kaplan, CEO of Onsale.com. "Forced to choose between doing nothing while some Internet entrepreneur eats their lunch and committing hundreds of millions of dollars to online retailing with little anticipated return, traditional retailers face some difficult decisions."[32] In the past, these constraints led traditional retailers to use the Internet to defend their market share from third-party cannibalization. Jupiter Communications found that only 6 percent of online sales in 1999 were incremental and therefore non-cannibalizing.

However, some traditional retailers are now viewing the Internet as an opportunity rather than a threat. They now see it as a logical extension of a storefront's physical presence, one that complements existing customer relationships, business processes, and distribution systems.[33] "Branding is a tremendous advantage," says Scott Silverman, director of Internet retailing at the National Retail Federation, "and cross-promoting it over the Internet and in physical stores will open up new selling opportunities." Melissa Bane, an analyst with the Yankee group, agrees: "Some of the smarter ones are starting to realize that it's their game to lose. They already have

[29] Economist Survey: Business and the Internet, "The real revolution," The Economist, June 26, 1999
[30] Kim Girard, "Online consumers oblivious to most Net brands," CNET News.com, June 24, 1999
[31] Red Herring Editors, "Open letter: get real," Red Herring, September 1999, p. 114
[32] Brian E. Taptich, "Less than zero margins," Red Herring, March 1999
[33] Blaise Zerega, "Getting virtual," Red Herring, September 1999, p. 124

the customers, and now they can use the Internet in their stores as a tool to expand their share of customers."[34]

Borders.com, one of Barnesandnoble's key competitors, is attempting to integrate its physical presence with the online environment. Borders has rolled out Internet kiosks in its bookstores. The company launched a pilot project in the fall of 1999 that linked the kiosks to its Web site, so that customers could check a database of some 3 million titles and then custom order titles through a store clerk. "Our strategy is to be the most integrated provider in our industry," says Borders Online president Rick Vanzura. Forrester's Cooperstein says, "It's better to leverage an asset than to ignore it." He believes that unlike Borders, Barnesandnoble.com has done little to tie itself to the brick-and-mortar stores its Barnes & Noble parent owns.[35] For instance, the two have different pricing and product return policies. The Barnesandnoble.com Web site says, "We can offer lower prices online because we do not incur the high costs associated with operating retail stores" and states that "purchases from Barnesandnoble.com cannot be returned to Barnes & Noble retail stores."

Unlike Barnesandnoble.com, Charles Schwab decided to absorb short-term losses to integrate the Internet with its offline presence. David S. Pottruck, its co-chief executive, noted that when the company merged its on- and off-line divisions in 1998 and lowered the charge for off-line clients from roughly $65 a trade to $30 (to match the online fee), it cost it between $125 and $150 million.

Also controversial was Barnes & Nobles's spin-off of the Internet division, with Bertelsmann owning approximately 40%. Bill Gurley, a partner at the venture capital firm Benchmark Capital, said: "The idea of a successful major retailer giving away 50 percent of its control of a division that is complementary to its core business sends exactly the wrong message to the Street. Should the correct message be, 'We believe in this business so much that we're going to give away 50 percent of the upside to somebody else'? Or would Barnes & Nobles have been better off if CEO Leonardo Riggio had stood up onstage and said, 'We believe in the Internet so much that we need you to come with us. We're going to lose money for a while, but we must invest and grow this part of our business, because it's going to be very important.'"[36] With critics questioning their strategy, executives at Barnes & Noble and Barnesandnoble.com need to decide to integrate the Internet division with the powerful parent brand.

BUY.COM

Scott Blum founded Buy.com in 1996 as Buycomp.com. The company's roots are in online computer hardware sales, but in November 1998, armed with $60 million in funding, Blum acquired Speedserve, an online retailer of books and videos, from Ingram Entertainment and quickly began to expand his company's offerings. Just before the 1998 holiday season, the company changed its name to Buy.com and grabbed attention by guaranteeing the Web's lowest prices on everything its family of Web sites sold, including software, games, music, and videos in addition to books and computer hardware.

Softbank, an investor in nearly 100 Internet companies, including Yahoo and E-Trade founded the company. John Sculley, Apple Computer's former CEO, and Don Kendall, PepsiCo's

[34] Bob Tedeschi, "Conventional Retailers Use Web to Improve Service," http://www.nytimes.com, August 16, 1999
[35] Troy Wolverton, "Borders sets up a Net hybrid strategy," CNET News.com, July 26, 1999
[36] Alex Gove, "In Play," Red Herring "Going Public", 1999, p. 64

founder and onetime CEO, sit on Buy.com's board. Buy.com posted $120 million of revenue in 1998, its first full year of sales, beating Compaq Computer's15-year-old record for a company in its first year. About 30 percent of Buy.com's customers come from the consumer market, about 40 percent from small businesses, and the rest from large companies and the government.[37] Revenue for the third quarter of 1999 more than quadrupled to almost $160 million from about $35 million a year earlier. In October 1999, the company filed for its IPO.

Buy.com guarantees to beat the prices of its top three competitors in each product category by 10 percent – even if that means selling the item at or below cost. This requires Buy.com to use a web crawler to scan the Web daily for prices. For the nine months that ended September 30, 1999, Buy.com said its cost of goods sold was $401.2 million, exceeding net revenue of $397.6 million for the same period.[38] Buy.com CEO Greg Hawkins says he plans to make money by advertising and selling services like installation and maintenance for its higher-end products, such as computers. Already, he says, Buy.com is making some money on shipping fees and by selling many of its diverse range of products above wholesale prices. "We clearly use some visible products as a means to acquire customers," he says, though "most of our products are priced above cost."[39] Blum is calling his plan "optometry economics." Believing customers will never again be so cheap to acquire, Blum plans to make money by attracting tens of millions of eyeballs to the Buy.com site and then using those numbers to lure deep-pocketed advertisers searching for an online audience. Blum bets that "the world's lowest prices" will attract so many shoppers willing to at least look at www.buy.com that he can sell his ad space at a huge premium to large, consumer-products companies.[40] Blum says, "Whatever it takes. The Internet doesn't have a lot of room to finish third. Our business model is to win."[41]

Many industry leaders think that Buy.com is on to something that will not go away soon. Benchmark Capital partner Bill Gurley says, "The lowest prices on the Web: that's a damn good marketing message. It sticks in your head."[42] "Buy.com may not be profitable for a while," says Forrester analyst Kate Delhagen, "but I expect it will do lots of business for a long time to come. This is a land-grab opportunity. The priority is not making money, but building brand and a huge customer database. Internet retailers will continue to practice extraordinary price gouging."[43] J. Neil Weintraut, the venture capitalist from 21st Century Internet Venture Partners, is even more enthusiastic: "Products are content! Companies use products to attract a critical mass of customers and make profits through a smorgasbord of collateral revenue streams!"[44]

Buy.com's reliance on advertising revenue has raised some skepticism, however. First, the saturation of the medium and the decline in response rates are pushing ad prices down. Second, Buy.com's demographic primarily consists of bottom feeders who only care about price and is thus less attractive to advertisers.

The Buy.com model also misses the issue of consumer price sensitivity. On big-ticket items such as computer hardware, Buy.com might have an advantage. But "when you're looking for a book on Amazon.com, you're just not that price sensitive," says Genni Combes, an analyst at

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[37] Mark Halper, "Zero Hero," Business 2.0, April 1999, p.58
[38] Bloomberg News, "Buy.com files for IPO," October 27, 1999
[39] Lisa Bransten, "The Bottom Line" Wall Street Journal, July 12, 1999, p. R10
[40] Mark Halper, "Zero Hero," Business 2.0, April 1999, p.58
[41] David Bank, "A Site-Eat-Site World," Wall Street Journal, July 12, 1999, p. R10
[42] Alex Gove, "In Play," Red Herring "Going Public", 1999, p. 64
[43] Brian E. Taptich, "Less than zero margins," Red Herring, March 1999
[44] Ibid.

Hambrecht & Quist in San Francisco. “Who’s going to say, ‘Oh my god, I saved 50 cents on the new [John] Irving novel’?” Yet Buy.com’s approach resonates quite well with the current “get a deal” culture of the Web. Its executives believe that as higher-ticket item sales increase, and online users’ income levels come closer to the nationwide averages, Buy.com’s model will win a significant segment of online buyers. “There’s always going to be customers who look for price, and there’s always going to be customers who look for service, just like some people shop at Saks and some shop at Wal-Mart,” said Eli Katz, president of e-commerce for Fragrance Counter and Cosmetics Counter. "That will hold true on the Web as well.”[45]

Brand loyalty is also a question mark for Buy.com. “It’s a brilliant concept,” says Buy.com board member and former apple Computer CEO John Sculley. “The way to look at it is not as selling below cost, but as building a branded franchise as the low-price leader.”[46] Lauren Cooks Levitan, an analyst at BancBoston Robertson Stephens in San Francisco, questions the consumer loyalty associated with this brand message. “These guys are setting themselves up to be price leaders, and so that’s all their customers are going to care about,” she says. “As they raise prices, those customers will leave.”[47] Other analysts argue that Buy.com can forge unique consumer relationships by leveraging its enormous database, which closely tracks consumers’ buying habits, to sell higher-margin targeted merchandise to its most active and loyal customers.

Another threat to the Buy.com brand is its poor reputation for order processing, order fulfillment, and customer service. A running joke claimed the best way to receive a quick shipment from Buy.com was to cancel an order, which would prompt it to rush the product out the door to collect payment. Customers have been outraged when Buy.com posted prices for much less than cost, and then rescinded the price for units not in stock.[48] Glitches in the execution of the company’s “virtual strategy” may account for these problems. Softbank, for instance runs two customer-support call centers for Buy.com, while Ingram Micro is its exclusive distributor in the computer business. Buy.com takes ownership, but never possession, of the product it sells: it buys the product from Ingram and sells it to the end consumer. Blum says this arrangement is superior to Amazon.com’s. “Our model is better than Jeff Bezos’. We have 85 employees, he has 2,100. We don’t have warehousing, he has warehousing. We don’t have inventory, he has inventory. His worst nightmare is he has to write off the value of inventory when he cuts price. Jeff Bezos has a business model that will never turn a profit.”[49]

MOBSHOP

> *Consumer power will rise up. If 1,000 prospective buyers of Toyota Camrys knew of one another’s existence, they’d have enormous potential clout. The Web makes it easy. Look for a boom in team buying and cyber-fleet sales.*
>
> Forbes Magazine, April 1999

MobShop (formerly Accompany.com) is an Internet-based network that leverages the power of the Internet to aggregate demand for products and services to pool consumers’ purchasing power. Once consumers decide which product to purchase, they join that product’s Buy-Cycle™. A graph that is continually updated to reflect the current number of buyers and the current price per

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[45] Ibid.
[46] Mark Halper, “Zero Hero,” Business 2.0, April 1999, p.58
[47] David Bank, “A Site-Eat-Site World,” Wall Street Journal, July 12, 1999, p. R8
[48] Mark Halper, “Zero Hero,” Business 2.0, April 1999, p.58
[49] Ibid.

unit of the product visually represents the Buy-Cycle. Each Buy-Cycle is separated into volume-tiers. As the number of buyers "fills" each tier, the price drops by the next increment. Exhibits 3 and 4 describe MobShop's dynamic demand aggregation model in more detail and provide an early example of the user interface (prior to the name change).

The company was founded in 1998 and raised $3.65 million during its first institutional round of equity financing. "The Internet, with its just-in-time demand fulfillment capabilities, is transferring power from the supplier to the buyer. Unlike auction commerce sites that pit buyer against buyer, or conventional retail sites where individual customers derive no value from each others' purchases, MobShop's buyer advocacy model encourages customers and suppliers to work together to extract the greatest value possible from volume sales."[50]

"We feel that [MobShop] will fundamentally change the way buyers and sellers do business on the Internet, shifting the balance of power from seller to buyer through aggregation, access and advocacy. We feel that a customer is truly empowered when marketed to one-to-one, yet able to transact many-to-one," said Jim Rose, CEO and co-founder. "Through our buyer-driven approach, we will redefine commerce, bringing people together from across the neighborhood, city, or nation to derive true value from the Web."[51]

MobShop is selling products for other e-tailers such as chipshot.com, GolfDiscount.com, Electronics.net, Roxy, Shades.com, Superbuild, Reel.com, and Fogdog Sports. According to the company, participating suppliers can reach an exponential number of customers without incurring additional incremental acquisition costs. Suppliers gain incremental revenue and profitability opportunities by dealing with larger purchasing parties. "[MobShop]'s innovative real-time demand coordination network will enable us to generate aggregate sales at a minimal marginal cost while attracting those fragmented consumers who traditionally are more difficult and expensive to reach," said Nick Mehta, Vice President of Marketing at chipshot.com.[52] "Sites are spending $40 to $60 per customer," CEO Rose says. "We say, 'why not take a $50 piece of software, get 20 buyers together and cut the price by 10%?' So instead of paying $40 to $60 for a customer, they're spending just $5."[53]

MobShop never takes possession of a product. Instead, suppliers agree to hold a certain amount of inventory for the duration of a sale and then collect between 2 and 6 percent of the sale.[54] By contrast, MobShop's primary competitor, Mercata.com, is essentially becoming a retailer by keeping in-house all fulfillment and customer-related functions. MobShop is not trying to become a destination site on the Web. Instead, it is selling its technology to other sites such as Excite@Home, which are privately branding it. Sites can hence increase the loyalty and stickiness of their site by expanding the purchasing power of their members. From MobShop's perspective, Rose argues, "The more access points we have online, the more consumers we have access to."[55] Demand is aggregated across all sites and not site-by-site. "There are only going to be a few dominant players in this space who can get enough volume on the front end," says Rose, referring to the chicken-and-egg problem faced by all intermediaries. "The problem is you need

[50] Accompany, "Accompany, Inc. to Revolutionize Commerce; Buyers Come Together for Best Value," www.accompany.com
[51] Ibid.
[52] Accompany, "Accompany, Inc. to Gathers Steam," www.accompany.com
[53] Penelope Patsuris, "Group Buying: the more the merrier," Forbes.com, August 6, 1999
[54] Ibid.
[55] Ibid.

lots of suppliers to add value and attract consumers, and at the same time you need lots of consumers in order for suppliers to get involved," says Jupiter analyst Mike May.[56]

Jim Rose is betting that a certain set of consumers will wait a few extra days to get a $1000 PC for $925 from CompUSA, with its service package included, and forgo getting it at that price immediately from Buy.com, without the service.[57] "What we didn't anticipate was that people would wait three days to get 50 cents to a dollar off a $20 Palm Pilot cover," he says. "But they're doing it." While the typical look-to-buy ratio on the Web is 1%, Rose claims the ratio on his site is five to eight times higher. He attributes this bump in part to the site's interactivity implemented through the "click and tell a friend" feature that lets users participating in a sale e-mail others who may be interested about it. "Human beings are far more effective at identifying others who are in the market for a product than any direct marketing program ever will be," says Rose. If a friend has mentioned he or she is in the market for a Palm Pilot, why not drop that person a line? "Also, people are far more inclined to trust someone their friends are already involved with," he adds.[58]As Jim Rose tries to aggregate buyers, develop partnerships with suppliers, and compete with companies like Mercata.com, he also has to consider that a player with an established brand and traffic such as Amazon or eBay might invade his niche.

PRICELINE.COM

Priceline.com, with its patented "name your price" model, enables brand-flexible consumers to save on goods and services. Priceline.com consumers' price requests to participating sellers, who can fill as much of that guaranteed demand as they wish at price points the buyers determine.[59] Priceline.com is currently applying its "demand-collection system" to three distinct product categories: a travel service that offers leisure airline tickets and hotel rooms, a personal finance service that offers home mortgages, refinancing, and home equity loans, and an automotive service that offers new cars on a test basis in the New York and Tampa metro areas. On November 8, 1999 Priceline announced that it would offer international and domestic long-distance telephone service in 2000.

Revenues increased to $152.2 million for the third quarter ended September 30, 1999, a 36% increase over the second quarter and a 1,654% increase over the same period in 1998. The company's net loss for the third quarter 1999 was $102.2 million, from $19.8 million a year earlier. On October 31, 1999, Priceline's stock was down 64 percent from its highest value of $165. The company went public in March 1999. Over 2.9 million unique customers have used Priceline's travel, home finance, and automotive services. "This dramatic growth in the business further substantiates the appeal of the Priceline.com concept among consumers and brand-name companies across a number of industries," said Priceline.com Chairman and CEO Richard S. Braddock. "By giving consumers the ability to leverage their brand flexibility for savings, and giving businesses a new way to move inventory without disrupting retail sales channels, Priceline.com offers a powerful new form of commerce that works."[60]

"Just six month ago, Priceline.com was selling an average of 5,000 to 7,000 tickets a week. Today, we sell six times that amount, or approximately 40,000 tickets a week. At peak times, we

[56] Ibid.
[57] Ibid.
[58] Ibid.
[59] Priceline.com, "Priceline.com Reports Second Quarter 1999 Financial Results," http://www.Priceline.com, July 1999
[60] Ibid.

receive a ticket request every second. Demand continues to increase strongly and we believe even a more significant portion of reasonable ticket requests can be satisfied with more inventory," says Braddock.[61] Priceline takes a bid from a consumer and compares it against the inventory its suppliers offer. In 1998, only about 7% of the guaranteed offers from consumers actually resulted in a sale. Priceline gets to keep the difference between the bid and the offer whenever a sale occurs. To grow however, Priceline has been accepting bids on tickets where it is losing money. According to the company's prospectus, "Priceline.com has chosen to sell a substantial number of tickets below its cost in order to increase airline and adaptive marketing revenues, build a record of successful transactions and enhance the Priceline.com brand."

Like any intermediary, Priceline.com has to balance the interests of suppliers and consumers, so that it can continue to grow. For example, with the company's leisure airline ticket service, travelers agree to fly on any major airline willing to accept their price. The airline releases fully confirmed seats on flights where it has empty seats that depart between 6:00 a.m. and 10:00 p.m. Flights may be non-stop or include at most one connection each way. Tickets purchased through the service are non-changeable and non-refundable, and consumers cannot earn frequent flyer miles. In other words, once an airline accepts a consumer's price, the consumer's credit card is automatically charged. The consumer cannot reject or change the offer or specify the time of day, the airline.

Some industry observers believe that this relatively unfriendly consumer product is appropriate for the targeted price-sensitive demographic. The Priceline "name-your-price" process is also a wonderful mechanism of price and latent demand discovery that can be leveraged in many one-to-one marketing opportunities. Others argue that because Priceline, with an unproven business model and no aggregated consumer base, had little leverage vis-a-vis its inventory suppliers when it first negotiated its inventory deals, it could not negotiate for a more consumer friendly service. Finally, some industry experts argue that by making the product so unfriendly, Priceline took a huge market opportunity – the 30 percent of all airline seats that largely go unsold – and narrowed it down to a small customer niche with unattractive demographics. "Excluding students and perhaps some time-insensitive retirees or part-time employees, there are not that many people with so much time in their hands. It does not take a rocket scientist to figure out that if I want to spend the weekend with my family, Priceline seats are going to be available on Friday morning and not in the afternoon when everybody else is also returning home." Also, an extremely price sensitive consumer demographic and a relatively "unsatisfying" consumer experience makes brand loyalty questionable.

Suppliers' fear of cannibalization and of putting downward pressure on prices affects the form of the consumer product. According to Braddock, suppliers are benefiting from incremental sales. "Airlines and hotels fill seats and rooms that would otherwise go empty and can do so without disrupting their retail pricing structure," he says.[62] Brad Jones, a Brentwood Venture Capital principal, believes that an inherent conflict between the interests of suppliers and Priceline could limit the company's growth potential. "If it had the potential to be incredibly successful and absorb a high percentage of sales for airlines, etc., the vendors would just sell tickets directly to

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[61] Ibid.
[62] Priceline.com, "Priceline.com Delivers Savings for Flexible Travelers in side-by-side Price Comparison," http://www.Priceline.com, May 28 1999

squeeze them out."[63] This upper limit to its growth may have caused Priceline to pursue horizontal growth by expanding into hotel rooms and financial and automotive services.

The term "reverse auction" refers to auction sites that give consumers control of the bidding and purchasing processes. Many in the industry began using the term to describe Priceline.com's method of letting consumers name their own price.[64] Priceline's growth has helped trigger many start-ups that attempt to implement demand driven, non-fixed pricing systems. Exhibit 5 outlines two of the alternative approaches in the reverse auction space. Despite these competitors, Priceline still enjoys a first mover advantage in the dynamic pricing space. Documents filed with the Securities and Exchange Commission (SEC) indicate. Priceline might license its patented "name-your-price" method to a "consumer-to-consumer transaction business" controlled by Jay Walker, Priceline's founder and vice chairman.[65] Buyers could make conditional purchase offers to acquire used goods, such as stereos, from other consumers. eBay's profitability and stock market valuation indicate the attraction of the auction market. Forrester Research expects the person-to-person auction market to grow from $2.3 billion in 1999 to $6.4 billion by 2003. The other growth opportunity under consideration would enable consumers to use the Internet to name the price they are willing to pay for retail merchandise. The consumer-to-consumer and retail merchandise ideas fit with Priceline's strategy of expanding its model horizontally to other areas of e-commerce.

Priceline would license the Priceline.com brand and the name-your-price concept to two new companies owned by Walker Digital, which is also controlled by Jay Walker, and might also invest in them. Walker expects to "devote a considerable portion of his time" to developing and implementing the consumer-to-consumer and retail merchandise Internet businesses. "Priceline is a company about big ideas," Walker says. "The long-term legacy of Priceline will depend on whether or not we can successfully introduce the first new pricing system in probably 500 years."[66]

MYSIMON.COM

Michael Yang and Yeogirl Yun founded mySimon in April 1998 to empower consumers to find the best prices for any product on the web. The company's backgrounder section explains:

> The mySimon shopping service evolved from the proprietary Virtual Learning Agent (VLA) technology, created by cofounder Yeorgirl Yun. VLA is a highly scalable information retrieval system that uses the power of next-generation intelligent agent and advanced parallel search technologies to automatically comb Web merchants' sites in real time. Search results offer instant product comparison based on price, availability and merchant information. With one click, users link to the merchant's "buy" page for easy purchasing. MySimon's Internet e-commerce hub is the largest comparison shopping site on the web, with over 1,000 merchants in categories such as Computers, Books & Music, Electronics, Fashion, Flowers, Sporting Goods, Toys, and many more. A one-stop, unbiased

[63] Edward Silver, "Net IPO Investors Think Like Venture Capitalists, Given Firms' Youth," http://www.latimes.com, August 9, 1999

[64] Microsoft's introduction of a similar price-matching product for hotel reservations (Hotel Price Matcher) has challenged Priceline's patent on its Internet based price-matching model. Priceline filed a patent infringement suit against Microsoft in October 1999.

[65] Bloomberg News, "Priceline may offer auctions among consumers," Bloomberg News, July 30, 1999

[66] The Industry Standard, "Idea Man," The Industry Standard, June 28,1999

> resource for smart shopping, mySimon helps shoppers find the best values on millions of products, saving visitors time and money. MySimon distributes its shopping service selectively to key third party web sites to achieve additional reach. In addition to the growing number of products to shop for at mySimon, the team is constantly expanding the breadth of its product categories and continuing its development of innovative features that will further simplify and enhance the web shopping experience.[67]

MySimon, which received $21 million in its fourth round of financing, competes in a space that has seen significant consolidation. Excite acquired NetBot and its Jango technology, Amazon.com bought Junglee, and Inktomi bought C2B Technologies. In January 2000, CNET announced its plans to acquire mySimon for approximately $708 million in stock. The combined entity will have 250 product categories and more than 2,600 merchants and advertisers. The acquisition enables CNET to quickly expand its online buying guides, product reviews, and shopping services far beyond the computer and consumer electronics markets. The sites will, at least initially, remain separate and maintain their individual brands. MySimon CEO, Josh Goldman, said that the CNET acquisition option gave the company the fastest way to integrate content such as product reviews and consumer feedback to its site. “It’s all about speed,” he said, “and we want to integrate rich media with comparison shopping to create more shareholder value.”[68]

MySimon’s original strategy was to charge a commission of 2 to 5 percent of each sale made to a buyer who accessed the merchant site through a mySimon search. “Our model is to become like MasterCard or Visa-they take a transaction fee every time,” said mySimon cofounder Michael Yang. Allowing merchants to place their logo or messages next to shopping bot results would generate more revenue. However, merchants don’t need to do so to be searched. Yang compares the sponsorship model to the Yellow Pages. “You can pay for an ad there, but you still get listed even if you don’t,” he says.[69] In practice, the sponsorship model proved more viable than the commission-based one. Retailers were more willing to pay to get preferential placement on the mySimon site than to give up 2 to 5 percent of their revenues every time mySimon referred an eventual buyer to their site.

MySimon is also pursuing a strategy of co-branding its service with portals and other sites to aggregate consumers and expand its reach. “The market is certainly there,” said Aberdeen Group analyst Mark Peabody. “The whole price comparison shopping space is very attractive to the user. Co-branding with major portal sites and specialty portal sites is an interesting model. Portals can now look at heading out into a market that doesn’t force you to get in bed with an Amazon.”[70]

Merchants are willing to be “comparison-shopped” because the Web traffic they get is motivated to buy.[71] “They want the traffic, and it’s high conversion traffic,” says Kirstin Hoefer, product manger of the Jango agent technology at Excite. Nicole Vanderbilt of Jupiter is less excited about the value of the traffic originating at sites like mySimon. “It’s a fine line between love and hate. Retailers never like to be side by side with their competitors” she says[72]. Most retailers want to

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[67] www.mysimon.com
[68] Penelope Patsuris, “MySimon says,” Forbes.com, January 20, 2000
[69] Clinton Wilder, “Agents go price shopping,” http://www.techweb.com, December 7, 1998
[70] Paul Festa, “mySimon to launch pricing site,” CNET News.com, October 26, 1998
[71] Clinton Wilder, “Agents go price shopping,” http://www.techweb.com, December 7, 1998
[72] Ibid.

build brands by having consumers come directly to their site. But no retailer can ignore the intelligent agent sites that have aggregated consumers.

While intelligent agents such as mySimon cannot for practical reasons search the entire Web, they come closest to bringing "perfect information" to the online buyer. Yet, the role of price comparison engines in the evolution of e-commerce is uncertain. Forrester Research estimates that price comparison engines will work for 30% of value-focused buyers who shop around, accounting for 22% of all on-line shoppers in 2003.[73] While mySimon executives believe that price comparison will become popular as higher-ticket item sales increase and intelligent agents become more sophisticated, others are skeptical. "It's been said that agents would change the dynamics of Internet commerce, and that certainly hasn't happened yet," said Julia Pickar, an analyst at Zona Research Inc. "They're making some waves with the most price-sensitive shoppers, but they're not for everybody."[74] Clinton Wilder, a senior writer at InformationWeek, argues that Web commerce is evolving into a marketplace that's more like the real world than many would have expected. "Surprisingly, branding and marketing matter a lot more on the Web than technology does. Moreover, customer loyalty has prevented rampant commoditization of products. Price matters, but not to the exclusion of consumer concerns like brand trust and service."[75]

According to Paul Gaffney, VP of commercial sales at Office Depot Inc., the intelligent agent concept can only be applied to easily definable consumer commodities. "But even then, what's the legitimacy of the lowest-price merchant? In some cases, agents actually work against 'perfect information' because price is just one part of that." This concern has led to the emergence of second-generation intelligent agents, sites that provide more than pure pricing information. For example: Bizrate.com aggregates merchant specific, consumer-generated feedback about all aspects of online shopping,[76] epinions.com aggregates product reviews and comparenet.com compares product features for different models.

Whatever the future of price comparison engines may be, one of mySimon's most important assets is the wealth of consumer behavior data it can track. MySimon can analyze consumer searches and the subsequent referrals to merchant sites to specific consumer behavior. Information-rich consumer profiles combined with the trust earned by being independent and unbiased can put mySimon in an advantageous position between consumers and retailers. John Hagel and Marc Singer argue in their book Net Worth that these intermediaries, "infomediaries" the authors call them, can leverage their position to launch value-added services. (Exhibit 6) Infomediaries can use information to attract more buyers and sellers and learn more about their business transactions to create a virtuous circle.[77]

Ironically, the Internet's most distinctive business model is a new kind of intermediary. "Only a couple of years ago, enthusiasts were predicting widespread 'disintermediation' when Internet commerce took hold. On the friction-free web, suppliers would be able to reach their customers direct without having to bother with greedy middlemen. Now intermediaries are suddenly fashionable again. Instead of 'disintermediation', the new buzzword is 'reintermediation.'"[78]

[73] Seema Williams, "Shopping Engines Threaten On-line Retailers," http://www.forrester.com, June 16, 1999
[74] Clinton Wilder, "Agents go price shopping," http://www.techweb.com, December 7, 1998
[75] Ibid.
[76] Including price, on-time delivery, site navigation, privacy etc.
[77] Economist Survey: Business and the Internet, "The Rise of the Infomediary," The Economist, June 26, 1999
[78] Ibid.

How mySimon and CNET will evolve their business model to capitalize on the opportunities created by their position between consumers and retailers remains to be seen.

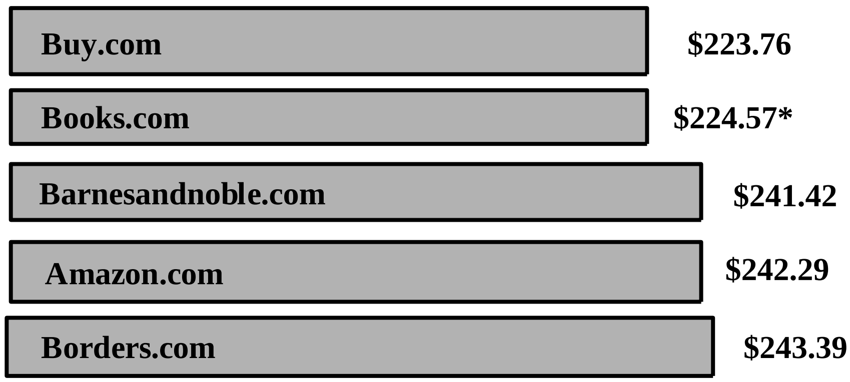
PRICING AND BRANDING ON THE INTERNET: CLOSING THOUGHTS

"In five years' time, all companies will be Internet companies, or they won't be companies at all," says Intel's Chairman, Andy Grove.[79] Few people doubt that the Internet is changing business and commerce. Despite its phenomenally fast evolution, however, it is still in its infancy. Which business and pricing models will prove to be sustainable in a rapidly growing environment where the types of products sold on the Internet proliferate and an increasingly segmented population goes online remains unclear.

[79] Economist Survey: Business and the Internet, "The Net Imperative," The Economist, June 26, 1999

EXHIBIT 1: BOOK WARS[80]

The total price at selected sites for a basket of 10 best-selling books and 10 miscellaneous titles.

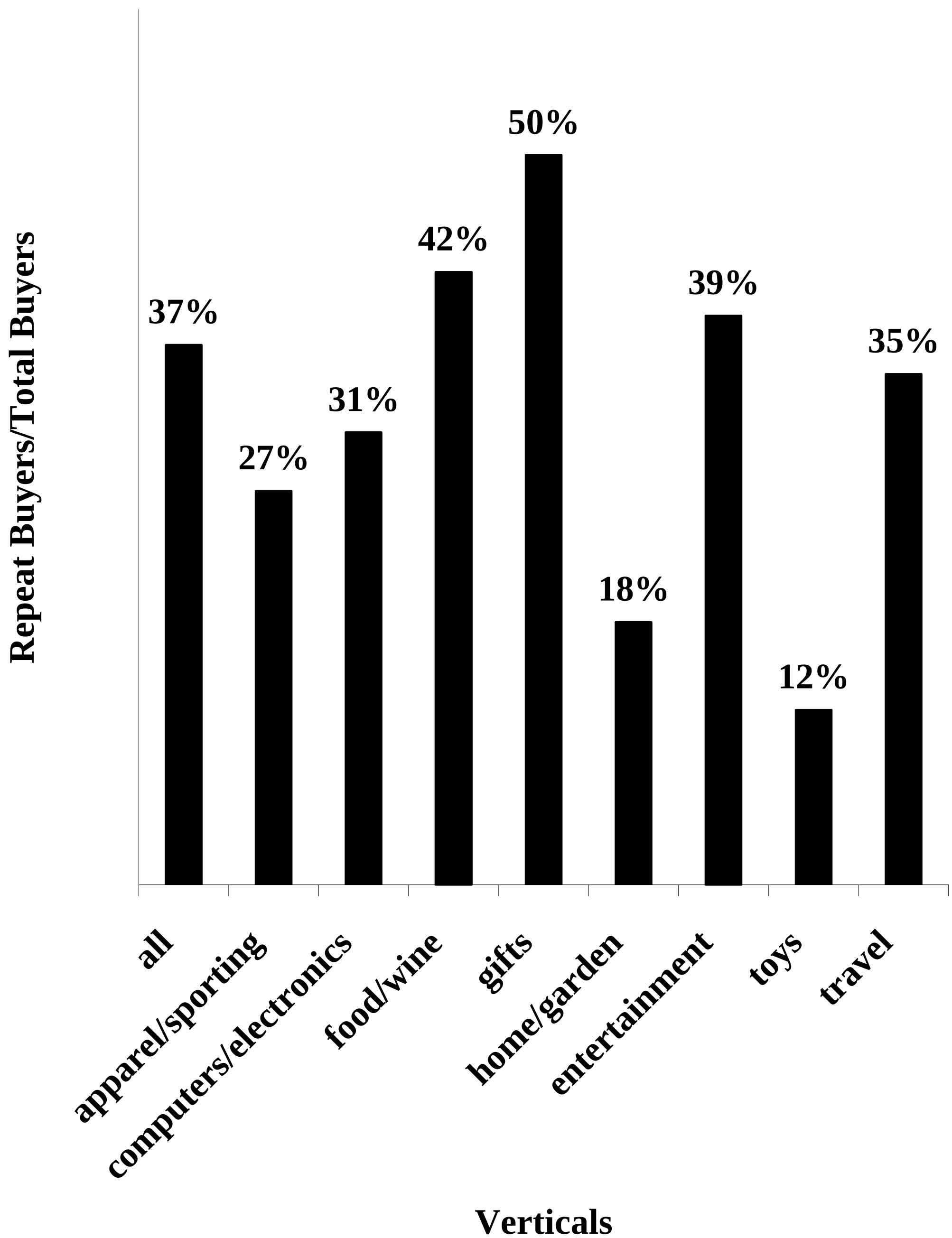


NOTE: Prices are as of late June and include shipping and handling for standard shipping based on an average of three books per order.

*The Books.com total assumes that the customer asked Books.com to match the best price at Amazon.com, Barnesandnoble.com and Borders.com. The Books.com total without matching would be $247.88.

[80] Reprinted with permission from Erik Brynjolfsson and Michael D. Smith, “Frictionless Commerce? A comparison of Internet and conventional retailers,” http://ccs.mit.edu/erik, May 1999

EXHIBIT 2: CONSUMER LOYALTY BY VERTICAL (1998)[81]



[81] Reprinted with permission from Shop.org/BCG, "The State of Online Retailing 2.0," July 1999.

EXHIBIT 3: THE MOBSHOP BUY-CYCLE™[82]

- Customers access MobShop's service directly or through a partner site
- Upon deciding which product to purchase, customers join that product's Buy-Cycle.™ A Buy-Cycle is the period of time during which an item is open for buyers to join the purchasing process. The Buy-Cycle is updated in real time; the more people who join, the more the price continues to drop.
- MobShop will aggregate each customer's demand using its patent-pending demand coordination engine, which enables individual buyers to transact as a group. Customers will be billed at the Buy-Cycle's close, usually at a price significantly lower than when they joined.
- The more people who join a Buy-Cycle, the greater value each participant receives. To that end, each customer is encouraged to refer friends and family to MobShop through its Click and Tell e-mail program.

[82] www.accompany.com

EXHIBIT 4: EXAMPLE OF THE MOBSHOP USER INTERFACE (BEFORE COMPANY NAME CHANGE)

Reproduced with permission from MobShop Inc.

EXHIBIT 5: ALTERNATIVE REVERSE AUCTION MODELS

NEXTAG

The NexTag service lets buyers negotiate over price with name-brand sellers of computer products. According to the company, NexTag's speedy way to purchase keeps the consumer in control of the transaction at all times. Unlike Priceline's service, the user has the comfort of knowing the agreed-to price before committing a credit card. Sellers can dynamically accept, decline or counter-offer bids with bundles, complementary products or different prices. NexTag chief executive, Purnendu Ojha, said that his service "enables sellers to compete for buyers," resulting in better prices for buyers and lower selling costs for sellers. While Ojha acknowledges that Priceline.com has done a lot of legwork in explaining the new purchase process to the market, he takes a shot at Priceline's strategy of not allowing any type of negotiation between buyer and seller: "We do not believe deals can be made until both sides agree on price," Ojha said.[83]

RESPOND.COM

Respond.com is another start-up attempting to give consumers more flexibility and control during the buying process. At the company's Web site, you simply type in a description of what you want, the price you're willing to pay, and your deadline. Respond then contacts its network of merchants without revealing the user's identity. If any of Respond.com's participating merchants accepts, you get what you seek at the price you want.[84] Sellers pay a listing fee for each category they are in. In the future, Respond.com is contemplating charging a nominal fee for each response to a prospective customer's e-mail. There are no transaction or user fees for the service. "Transaction fees would limit their scalability," says Jupiter Communications analyst Michael May. "What's attractive about their model is that it integrates well with consumer behavioral patterns on the web, but unlike Priceline there's no commitment on behalf of the buyer. As their network grows, however, there is an increased likelihood that each bid will result in a purchase."[85]

[83] Tim Clark, "New Service targets Priceline," CNET News.com, August 7, 1999
[84] Tom Spring, "Reverse Auctions: A New Spin on E-commerce," July 29, 1999
[85] Charles Dubow, "Respond.com: The Reverse E-bay," August 4, 1999

EXHIBIT 6: THE INFOMEDIARY BUSINESS MODEL

According to John Hagel and Marc Singer's Net Worth, infomediaries can leverage their consumer profiles and position of trust to introduce consumer services that include:

- Targeted/Permission Marketing where the consumer agrees (opts-in) to be contacted for targeted promotions or other direct marketing opportunities in exchange for providing some level of personal information to the infomediary.
- Agent Services where the consumer makes a request about a service (e.g. insurance, travel, etc.) or a product (e.g. hard to find item). The infomediary then contacts a network of suppliers attempting to satisfy the consumer's request.
- Group Buying where the infomediary aggregates consumer demand to provide consumers with volume savings (similar to the MobShop model).
- Market Research where the infomediary provides vendors with targeted marketing research services.

The infomediary collects a "connection" fee from each transaction it facilitates. According to the McKinsey & Co projections, infomediary revenues start at $13 million in year one and increase to $4.9 billion in year 10. These revenue-generating services are coupled with privacy and filtering services that are aimed to protect consumers from unsolicited marketing (spam).