CASE STUDY 1

Amazon.com

Introduction

In the early 1990s Jeff Bezos was a young computer programmer on Wall Street, the financial district of New York. Intrigued by the development and potential of the internet, Bezos decided to give up his career to explore the business opportunities that this new medium of communication could offer. Setting up in business from his garage in Seattle he decided to set up an online book-selling business. The rationale for this choice was his belief that most people would be prepared to take the risk of online buying for a product such as a book. If the experience proved unfulfilling then they could exit the market and return to traditional forms of buying without too much of a financial loss. Of course, Bezos was determined that the experience of buying online would become a compelling alternative to traditional shopping and he set about developing a service that could offer real added value to customers.

The benefits of using the internet for buying books and other products were identified as:

- Greater selection;
- Convenience;
- Ease of use;
- Information search and retrieval capability;
- Ease of access from multiple locations;
- Competitive pricing;
- Price comparison capability;
- Personalisation.

The key components of Amazon.com's offerings include:

- Browsing;
- Searching;
- Reviews and content;
- Recommendations and personalisation;
- 1-Click technology for fast checkout service;
- Secure credit card payment;
- Availability and fulfilment;
- Interactivity with other customers;
- High level of customer service.

There are a number of web-based activities and services available to customers on Amazon.com's website. Customers can:

- Order books;
- Conduct targeted searches from the database of around five million titles;
- Browse highlighted selections;
- View bestseller lists and other features;
- Read and post reviews;
- Register for personalised services;
- Participate in promotions and check order status;
- Purchase gift certificates.

Bezos was able to use his contacts from the financial world to help attract sufficient investment funds to initiate the business plan and he decided to call his new venture Amazon.com. In the initial phase, Bezos handled customer orders himself but this soon changed as the volume of orders increased. Specialist distributors were hired to deliver books to customers in quick-time. The quality of the delivery service was crucial to the Amazon.com concept of making online buying quick, convenient and cheaper than traditional methods.

Importantly, Amazon.com became the first-mover in the e-tailing sector and was able to build a brand name that quickly became recognised in key markets where connectivity and interactivity rates were soaring. In 1997 Amazon.com was floated on Nasdaq, the US market for trading shares in high-tech companies. By 1998 the net sales of the company were $540 million compared to $148 million the previous year. However, actual profits remained elusive.

The Amazon.com business model for online bookselling

The initial concept of Amazon.com was to create a virtual bookshop on its website. Bezos believed that this would create a competitive advantage from a number of sources including offering a greater range of titles; greater convenience for customers; 24-hour access; quick and efficient search capability; and a competitive price based on lower transaction costs. One of the key advantages the bookselling industry enjoys is the fact that it is mostly information driven.

Information is the raw material with which publishers produce products in the form of books and booksellers depend on data regarding book genres, design, price, print-run and delivery times. Booksellers use the internet for book search services, ordering and payment, after-sales services and for delivery systems. Information is collected through feedback from authors, customers and a host of book reviewers.

This ever-expanding bank of information creates a network between all the interested parties in the book buying and selling arena. This is in contrast to the linear relationship that has traditionally characterised interaction between the main players in the book publishing industry. Figure CS1.1 illustrates the linear value chain relationship in book publishing. Figure CS1.2 illustrates a publishing and bookselling value network.

Amazon.com is the leading proponent of utilising e-commerce applications in the bookselling arena. The model outlined in Figure CS1.2 forms the basis of the Amazon.com business strategy. A key asset is the ability of the firm to build and enhance relationships across the value chain. Customers, authors, publishers and distributors all contribute to the increasing bank of in-house and market information required to respond to requests from customers.

Customers include those who purchase books, publishers who request market information and book resellers who also rely on

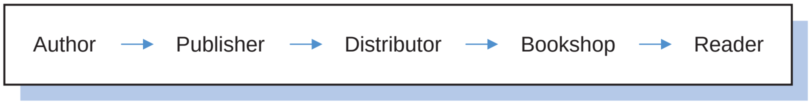

Figure CS1.1 Linear value chain in traditional book publishing. Adapted from *Electronic Commerce: Strategies and Models for Business-to-Business Trading* by Paul Timmers (1999) with permission from John Wiley & Sons

Amazon.com services. The former constitutes business-to-consumer (B2C) e-commerce whereas the latter two are business-to-business (B2B) e-commerce. Amazon.com created two groups to specialise in B2B e-commerce: Amazon.com Advantage offers services for publishers and Amazon.com Associates deal with book resellers. The value network permits each party to offer different roles depending on the value functionality offered. Thus, crucially, all functionality is vested with Amazon.com.

Timmers (1999) identified a business configuration emphasising value networks. Four main elements comprise the model and include community building, sales interface, core information management, and core handling and processing. Figure CS1.3 illustrates the functions comprising the business configuration.

Information to authors and customers forms the basis for building up the community within the bookselling process. The sales interface relies on building up a bank of knowledge from each and

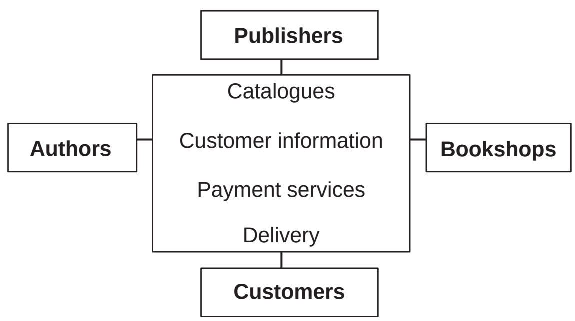

Figure CS1.2 Publishing and bookselling value network. Adapted from *Electronic Commerce: Strategies and Models for Business-to-Business Trading* by Paul Timmers (1999) with permission from John Wiley & Sons

STRATEGY	FUNCTIONALITY
Community building	Author/customer supplied information related to specific books.
Sales interface	Direct customer order intake and the registration of individual shoppers. Indirect via Associates.
Core information management	Building and providing access to book catalogue; building customer database and the value-adding information.
Core handling and processing	Payment processing, shipping and delivery services.

Figure CS1.3 Business configuration strategies and functionality of Amazon.com every sale whether from readers (through Amazon.com) or resellers (through Amazon.com Associates). Core information management builds and provides access to the Amazon.com catalogue of books and is linked to Amazon.com Advantage. The customer database also provides value-adding information. Finally, core handling and processing maintains payment services between the company and its customers whether they be readers, publishers, resellers or authors. This function also covers shipping and delivery administration. From this configuration it is clear that the process of bookselling is much more dynamic than the traditional linear model with each party in the process interacting with greater intensity.

It can be seen that bookselling is only part of the Amazon.com operational strategy. Readers form the core customers in terms of business-to-consumer (B2C) operations but another important strategy is to develop services based on information for publishers and bookstores – business-to-business (B2B). By providing access to information covering a huge range of books worldwide Amazon.com have built a catalogue which publishers and bookstores value.

The low cost and ease of access make it an attractive online system for practitioners across the industry. With each click on the system Amazon.com increases its bank of knowledge and extends its customer reach. Also, with each successive 'click of interest' the brand name of Amazon.com becomes ever more ubiquitous. Each site has local characteristics, including language, thereby allowing Amazon.com to claim to be a truly global phenomenon, not just in terms of customer reach, but also culturally.

The growth of the Associates aspect of the business has been without precedent in the publishing world. In September 1997 Amazon.com had 15 000 bookselling associates (Timmers, 1999). By September 1998 this figure had risen to 150 000. Indeed, most of the figures relating to Amazon.com. are spectacular, such as the 135.2% revenue growth rate in the year to the end of 1999 and the $720 million loss registered over the same period. The market value of the company saw a decline to $12 billion in 2000 from a $23 billion peak in 1998. Results in the first quarter of 2000 showed signs of improvement as losses declined to $308 million. This was as a result of the company increasing its focus on efficiency and financial prudence in order to allay the worst fears of investors and to counteract the increasing competitive forces in the market for online bookselling.

First-mover advantages

Amazon.com's first-mover advantages have enabled the company to amass a huge market value. Barnes and Hunt (2001) assign much of the value to perceptions of Amazon.com being not just a bookseller but also a mechanism for selling a variety of goods. One of the most valuable assets possessed by Amazon.com is the computer software developed to enhance customer benefits through database management. The core competence of the firm lies in the added-value service to customers that the software provides and that the highly skilled Amazon.com workforce exploit. A crucial first-mover advantage enjoyed by Amazon.com is the development of network externalities.

The internet is an ideal medium for creating increasing benefits for increasing numbers of customers joining the network. As customers are not charged for these benefits they are termed 'network externalities'. Amazon.com is among many e-commerce firms who have developed business models around the concept of creating virtual communities, internet auctions, value chain integrators and a host of other applications. The more the community grows the greater the attraction of joining because information service continues to rise but the cost to users is static.

Amazon.com, through its monopoly status between 1995 and 1997, was able to develop a large and loyal customer base that later entrants had to overcome in order to compete effectively. The computer software technology was (and remains) the key to sustaining competitive advantage in the face of increasing rivalry in the online bookselling industry. Amazon.com has gone to great lengths, including litigation, to protect the firm's development of software technology against imitators.

Branding and building customer loyalty are other important first-mover related advantages for Amazon.com. Their reputation based on service is vital for effecting customer loyalty. This is especially cogent to Amazon.com since their 'product' is essentially an experience good – that is, the quality is unknown until used (technically, Amazon.com could be deemed a logistics company under the Hypertext Markup Language (HTML) code rather than a bookseller).

The company has based its strategy around brand recognition and superior service such that customers are reluctant to switch to rivals even if the cost of doing so is zero. Indeed, the issue of switching costs are themselves a source of first-mover advantage.

New entrants have to contend with the knowledge that customers are already familiar with the *modus operandi* of the first-mover's website. However, in the case of online book buying there are many more potential customers than actual ones and, therefore, the competitive advantage enjoyed by Amazon.com is likely to be diluted as new entrants vigorously pursue old and new customers alike. Again, this makes competitive advantage through being the first-mover difficult to sustain.

Amazon.com experienced exponential growth in sales and stock value through exploiting first-mover advantages and monopoly status between 1995 and 1997. However, as noted, the Amazon.com business model attracted imitators. Even though most books continue to be sold through traditional retail methods, the potential of the online market was sufficient to attract big name booksellers such as Barnes & Noble, Borders and, latterly, Waterstones. Many of the business models and website designs of new entrants closely resemble those developed by Amazon.com.

Partnerships

Corporate partnerships are an important element of the Amazon.com strategy. The company has formed alliances with portals (internet search engines) and Internet Service Providers (ISPs). These offer access to heavily trafficked websites that play a crucial role in directing customers to the Amazon.com website, thereby increasing the company's brand awareness and market share. These alliances form critical elements of the company's strategy for achieving growth quickly.

There are mutual benefits that derive from such alliances. The high profile of Amazon.com offers 'corporate' sponsors such as the *Star Wars* franchise, the opportunity to gain exposure from the website. A sample list of some of Amazon.com's partners illustrates the breadth of interests the company has:

AOL (Internet Service Provider)
Adobe (Internet graphics)
Back to basics (toy catalogue)
Della.com (online wedding registry)
drugstore.com (health, beauty and prescription drugs)
exchange.com (rare products)

eZiba.com (world crafts)
Gear.com (designer sportswear)
Greenlight.com (online car sales)
HomeGrocer.com (home delivery service for groceries)
Internet Movie Database (movie and entertainment information)
Kozmo.com (one-hour delivery service for entertainment and convenience products)
Motley Fool (online brokerage of financial products)
Magellan Internet Guide
Netfind (Internet search)
Pets.com (pet supply shop)
sothebys.Amazon.com (auctions).

Expansion of services

Throughout the history of Amazon.com the strategy has been consistent – to grow quickly. This has entailed expanding the types of services offered to customers either through innovation of existing capabilities or through acquisitions. The expansion of the product portfolio was a natural progression from online bookselling and included videos, CDs, gifts, toys, healthcare products, gardening tools, electronics and digital products among many others.

Amazon.com have also acquired internet companies that brought specific capabilities that Bezos felt could not be developed internally. Exchange.com (www.exchange.com) ran a bibliographical database of around ten million hard-to-find and rare books. It also had lists of thousands of independent dealers and retailers. Amazon.com also acquired Alexa Internet (www.alexainternet.com), a company that specialised in compiling Web navigation software. A third acquisition was of Accept.com (www.Accept.com) an Internet start-up company run by former Netscape employees that specialised in developing technology for online transactions.

A further acquisition was of the Internet Movie Database (a partner company of Amazon.com) which emphasised the synergies that Bezos was looking for in his acquisition strategy. The Internet Movie Database had a very popular website featuring movie and entertainment information and had links to Amazon.com for every related book, movie or CD. Amazon.com also opened a shopping site called 'Shop the Web' that is designed to link shoppers with websites of products that Amazon.com do not sell, such as clothing.

Another venture involved entering into competition with e-Bay by setting up the auction site Amazon.comAuctions.

The expansion was not all about acquiring other internet-based firms though. Amazon.com ventured into the 'bricks-and-mortar' world by investing in warehouses to stock their books and other products ready for delivery. This added greatly to overhead costs but was deemed necessary in order to have some controlling hand on the distribution element of the business and to meet its promises in terms of order fulfilment. The company has also expanded geographically with the launch of several international websites sporting the Amazon.com brand including in the United Kingdom (www.amazon.uk) and Germany (www.amazon.de). These sites share the customer database of the parent company but are located in their respective countries and sell mostly titles indigenous to those countries.

Amazon.com has also extended its service to providing a platform for other firms who seek to exploit the popularity of the Amazon.com website. For a fee, Amazon.com allows other companies to use their website as a channel for selling their products to customers. Many traditional bricks-and-mortar retailers, such as Toys R Us, use the Amazon.com site for this purpose, as do many thousands of small-scale businesses.

This development has marked a shift in the business model of Amazon.com from one entirely geared towards products and services within the company's portfolio to one that incorporates a service for helping customers find what they want. This shift can be viewed as a strategy for competing with e-Bay in the market for bringing buyers and sellers together. To this end, Amazon.com have rolled out a Yellow Pages service that offers enhanced business listings, including digitally enhanced maps for locating businesses. The service also offers a call-up capability where customers can phone a business simply by clicking a button on the screen.

Expanding sources of income

Apart from the revenue gained from providing an e-tailing service to customers, Amazon.com also receives income in other ways. One method involves providing online advertising space on the website. Amazon.com provides space for banner advertisements that other organisations wish to place to promote their products or services. Amazon.com also acts as an affiliate site for other web-based organisations. This is where traffic can be diverted to other sites via the Amazon.com web pages.

Amazon.com also gains additional income from so-called 'co-op money'. Publishers have traditionally given 'co-op money' to retail bookshops for prominent display sites in the shop or for advertising titles. In print advertising this is deemed a 'co-operative' venture since the bookshop and the publisher share the cost of the advertisement since both are being advertised simultaneously. Amazon.com, as a virtual bookshop, receives 'co-op money' from publishers for high visibility on the website. Publishers also have their titles placed in prominent book reviews on the website. Some critics have argued that this practice is unethical because it blurs the line between the editorial function and advertising. Nevertheless, these 'paid for placement' titles provide a lucrative extra source of income for Amazon.com.

The crisis years 2000–2

The growth of e-commerce has been one of the great business stories of the late twentieth century. At the forefront of this phenomenon has been Amazon.com. With its leader Jeff Bezos at the helm providing energy and vision the company built it's e-tailing around bookselling and then other areas such as music and video. Key to its initial success was the ability to win customers and maintain their loyalty. Investors rushed to pump money into the venture and Amazon.com's share price rocketed in 1998. With a clear strategy and business plan formulated it appeared that the prospects for Amazon.com could only get brighter. However, three years on from its stock market flotation Amazon.com was in crisis. On June 23, 2000 analysts Lehman Brothers reported that Amazon.com would run out of money within a year. Debts had built up significantly since 1997 and yet there remained no sign of profit.

Alongside many other dot-com firms, Amazon.com found investors bailing out in early 2000, thereby cutting the share price by some 20%. By 2001 the Amazon.com share price had fallen to $11 from a peak of $110 two years previously. New internet companies had soaked up investment capital like a sponge based on little more than potential future profits.

The success of Amazon.com was built on its knowledge and expertise in online bookselling. Essentially, this was the core business – both B2B and B2C. The initial business strategy did not include ventures into other areas of retailing. After a series of acquisitions and partnerships Amazon.com entered other markets. Fuelled by deficit spending Amazon.com drifted from the core activity of bookselling where they had garnered much goodwill. By diversifying into other areas of e-tailing the company diluted the effect customer loyalty played in attaining investment credibility. The expectation that the company would be self-sustaining by the time the market corrected proved to be erroneous.

During the late 1990s e-commerce was still an evolving way of doing business and the savings it could bring to organisations had yet to translate into profits. For instance, the delivery of goods after an internet sale remained sluggish in the first few years after the rollout of the internet for commercial purposes. Also, maintaining inventory and warehousing meant Amazon.com incurred high costs in order to guarantee availability of goods. This problem was exacerbated by spreading the portfolio of goods ever more widely. The business model formulated by Amazon.com was heavily dependent on the e-commerce aspect of operations and the benefits that lower transactions costs would bring. The dynamic value network incorporating authors, publishers, bookshops and customers relied on the internet for the dissemination of information between the various players.

To compound the problems facing Amazon.com during this period the company faced increasing competition from rivals, particularly in the B2B element of their service as other leading booksellers built online systems for customers within the book trade. In October 2000, Amazon.com suffered the demise of the alliance with Internet Service Provider (ISP) Yahoo! To make matters worse Yahoo! then formed an alliance with Amazon.com's biggest rival, Barnes & Noble. More worryingly Amazon.com also briefly lost their market share leadership to Borders Bookshops (who later became a partner of Amazon.com) in 2001.

The competitive advantage that Amazon.com had built up since 1995 was being eroded by its main competitors Barnes & Noble and Borders Bookshops. One of the important features of competitors' strategies was the convergence of the retailing and online businesses. Barnes & Noble and Borders set up strategic links between the traditional methods of bookselling and the new one in the form of the internet. Barnes & Noble set up hundreds of internet counters in their retail shops, broadening the choice for customers in terms of purchase arrangements, delivery and collection. Borders fared well principally because of its focus on the sort of detail that customers want. Order totals were posted to customers before any credit card details were requested and they had a comprehensive and up-to-date list of book stocks.

Other competitive pressures came from publishers and booksellers who maintained and built upon their own in-house catalogues. In terms of distribution Amazon.com had to operate in a highly competitive world market for shipping and transportation of products. During the first five years of Amazon.com's existence distribution was not one of the company's core strengths.

There were also human resource issues that Amazon.com had to contend with that threatened to undermine the company's reputation. Despite the fact that the company was at the leading edge of 'new economy' business, the majority of the jobs performed by workers were distinctly 'old economy' in nature. Most work involved handling customer service calls and packing in warehouses. Many Amazon.com workers were part-time or temporary staff working long shifts. There was no recognised trade union in Amazon.com as Jeff Bezos argued that every worker had some part ownership of Amazon.com. The rationale for this position stemmed from the fact that Amazon.com workers were given the option of buying stocks in the company after completing a set period of working tenure. However, since the share values of dot-com firms had collapsed in 2000, this option became less attractive and the demands for trade union recognition grew among the workforce.

The key human resource issue facing Amazon.com is one that affects many firms in the new economy – the gulf between workers and management in the transformed business environment. Workers generally want job security and stability, whereas managers need to embrace change and establish a flexible organisation that can change quickly according to the vagaries of the market. Maintaining worker satisfaction in this environment is a challenge that few new economy firms have succeeded in meeting.

Turnaround 2003–5

The Amazon.com strategy for creating competitive advantage is now well established and has remained consistent since its inception in 1995. Jeff Bezos had a guiding principle that the internet was all about swapping real estate for technology and that the former almost always gets more expensive as time goes by whereas the latter gets cheaper (remember Moore's Law).

To leverage the greatest competitive advantage from utilising new technology in the form of the internet, Bezos always maintained that Amazon.com had to grow as big as possible as quickly as possible. The way he achieved this is based on: the first-mover advantages that built brand loyalty and captured the major slice of market share; the strengthening of the Amazon.com brand name to become a globally recognised business; and the development of new products and services through innovation and partnerships with other organisations.

The competitive advantage has been sustained through repeat purchases by customers who are loyal to the Amazon.com brand either through perceived added value or 'lock-in'. This has provided a formidable barrier to entry in favour of Amazon.com. Another source of competitive advantage for the company has been through developing proprietary technologies that facilitate a range of activities and functions such as website management, search capabilities, interactivity with customers, transaction-processing, distribution logistics and payments.

After the dot-com crash of 2000 Amazon.com had to ensure maximum efficiency to prevent debt spiralling out of control, whilst continuing the expansion of products, services and markets. Key aims were identified as reducing the burden of debt, lowering costs and increasing efficiency whilst continuing to expand the product line and entry into international markets.

Reduce debt, lower costs and increase efficiency

By 2001 Amazon.com had amassed debts of over $2 billion. To address this burden the company bosses embarked on a relentless cost-cutting exercise right across the business. This was designed to link into improving efficiency as well as helping to reduce costs. The main focus for increasing efficiency lay in the warehousing and distribution functions within Amazon.com. The company had invested in a sophisticated distribution system that ensured targets for delivery times were met. However, the system was complex and expensive to run. Amazon.com's senior vice president, Jeff Wilkie, set about the task of reducing Amazon.com's fulfilment costs. One method adopted was the use of Six Sigma DMAIC (define, measure, analyse, improve and control) reviews to identify sources of inefficiency. This led to Amazon.com's operations team being able to effect improvements in the accuracy of inventory records. The reputation of Amazon.com depends on meeting its delivery promises and this means knowing exactly what there is on the shelves of every warehouse and distribution centre at any given time.

Another efficiency improvement featured changes to the way the work of temporary employees was checked. Traditionally, when temporary workers were hired to stock items in the distribution centres there was no additional layer of verification to ensure that each item was placed in the proper place. This was the catalyst for introducing a new fulfilment auditing process to reduce the number of mistakes by temporary workers.

Continued expansion

Amazon.com has expanded into product and market sectors other than books. Product development is a key strategic direction for the company as it seeks to use innovation and technology to maintain its position as market leader in online trading. The company now has online websites for products as diverse as health products and garden implements. Amazon.com has also undertaken expansion geographically with investment in new ventures in Europe and Japan. The company seeks growth through acquisition of, and alliances with, internet and entertainment related firms.

Amazon.com has had to face a number of difficulties as a result of adopting strategies of low cost, growth, and expanding the product and service range. There have been labour relations problems relating to long hours and low pay that have resulted in the increasing desire for unionisation among the Amazon.com workforce around the world. There have also been some cultural problems associated with the Amazon.com expansion into other markets, most notably in France where Jeff Bezos made the *faux pas* of criticising the 'art' of comic writing not realising that this art form is afforded high cultural status in France. However, in terms of expanding the Amazon.com e-tailing concept it is clear that the new range of products sold on the internet has become as successful as bookselling. The Amazon.com brand is primarily recognised as an online bookseller but the expansion into products such as toys, health products and garden tools has gained in prominence and now represents important elements of the company's product portfolio.

The generic strategy of Amazon.com

The generic strategy of Amazon.com can be identified as 'differentiation'. This is a deliberate strategy and not 'stuck in the middle' as Porter would caution. Internet firms have to differentiate in order to raise the profile of their website against the myriad rivals in an over-crowded market. As first-movers in the e-commerce bookselling market, Amazon.com created a distinct brand image. Since 1995 their main rivals have been playing catch up in this regard. Amazon.com also differentiates the service provided to customers by using market share to create online communities whose members can share information and ideas on shared interests.

The software that Amazon.com applies to its operations is another important differentiator. This facilitates quicker and more efficient services for customers; makes navigation of the website easier; smoothes the process of ordering, transactions and distribution; and helps build knowledge on customers through database management and customer relationship management (CRM). The relationship that Amazon.com has with its millions of customers is the key differentiator that sustains the company's competitive advantage. The Amazon.com site extends beyond business-to-consumer information on purchasing but also includes a well-established consumer-to-business aspect including hundreds of millions of customer ratings and product reviews that form the basis of its all-important recommendations to buy.

Amazon.com has also pursued opportunities for reducing costs by taking advantage of low transaction costs. Low transaction costs are a feature of trading on the internet and Amazon.com have been able to pursue the possibilities that this presents in terms of providing the most competitive service at minimal cost. Cost reductions and efficiency savings have also been gained using software applications to automate and control functions such as order processing, warehousing, logistics and distribution.

The guiding principle: Get Big Quick!

The guiding principle behind the Amazon.com strategy has consistently been to 'get big quick'. During the crisis years Jeff Bezos came under pressure to slow the rate of expansion the company had embarked upon. Investors were nervous of the spiralling costs of adding ever more product ranges to the portfolio, the costs of warehousing, and the expansion into new markets such as Canada and Japan. However, by 2005 Amazon.com was reporting a strong financial turnaround that vindicated the Bezos approach.

Since 2002 Amazon.com has been able to reduce debt, improve cash flow and report small profits. The improved cash flow is important because it means that Amazon.com can more easily manage its debts. This is likely to ensure long-term survival for the company. Perhaps the most important figures are the ones that highlight the increasing popularity of Amazon.com year on year. Amazon.com had 14 million customers in 1999, 20 million customers in 2000, 25 million in 2001, and so on. By 2005 the company had almost 50 million active online customers worldwide. Sales have grown from \$148 in 1997 to £8 billion in 2005.

The main assets of Amazon.com

As first-movers in bookselling e-commerce Amazon.com have built a world-class brand name, differentiated and highly recognised across a number of important territories including the USA, Europe and Japan. This creates competitive advantage because of the customer loyalty it brings. Once engaged in the Amazon.com virtual community few customers switch to rival online booksellers.

Information is the product that Amazon.com sells. It has more data on books, authors, reviews and prices than any other online bookseller. It has a customer base of 10 million worldwide all of whom add to the bank of knowledge for Amazon.com. The information acts as a magnet to those in the book trade who rely on it for gaining valuable insights into what customers want and what they are buying. This creates competitive advantage in business-to-business (B2B) trade and provides Amazon.com with the opportunity for cost leadership in the market for services to other sectors of the book trade.

The high profile of Amazon.com attracts specialist internet firms who seek to form partnerships and bring expertise and economies of scale through marketing, management and technology. Each area of expertise creates its own sphere of influence in creating competitive advantage. Partnerships are mutually beneficial for the companies involved and form an important aspect of the Amazon.com strategy. Finally, the drive, energy and vision of founder Jeff Bezos is a key asset to Amazon.com. The brand name is synonymous with the management ethos, particularly in the USA. This creates competitive advantage for Amazon.com through the positive association in the minds of customers.

The future

The future aims of Amazon.com are to continue expansion of products and services through innovation and applying new technology; to continue to expand into new markets and become a truly global competitor; to reduce the burden of debt in the medium term (next five years); and to continue to be market leaders in online bookselling as well as consolidating their position in the range of new online products. Amazon.com intend to maintain growth levels through acquisitions and alliances, continue to add value for customers, and achieve the status of price leaders in the market whilst maintaining high quality.

A number of strategic options are available to Amazon.com to achieve their objectives in terms of products, markets and finance.

- Products/services – maintain existing services and develop new ones through innovation and use of technology;
- Markets – Amazon.com have the strategic option of pursuing globalisation through their world-class brand name. They can also target specialist markets where the use of the internet is of clear added value to customers. This stems from the added value for customers and the cost reductions for Amazon.com. To remain as market leader the company must continue to differentiate its services in its target markets and take a pro-active approach to developing applications through the use of technology. As the company expands its operations around the globe it is an increasing imperative that decentralisation of management takes place. To maintain customer loyalty the Amazon.com service has to be culturally specific and relevant to the needs of each market.
- Finance – it is of great importance that Amazon.com continues to reduce debt. This may entail increasing share issues to raise finance or seeking further investment funds. The company must balance the cost

savings in terms of offering competitive prices for customers with the need to effect expansion within a controlled budget whilst reducing debt.

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CASE STUDY 2

e-Bay

Introduction

Pierre Omidyar is the son of French-Iranian parents who arrived in America in the early 1970s to pursue academic careers. Omidyar was a student at Tufts University near Boston where he spent much of his time exercising his passion for Apple programming. A move to Silicon Valley, the nerve centre for US technology development, was a natural progression for the self-confessed computer nerd. In 1991, Omidyar founded his first business called 'Ink Development Corporation' specialising in producing software for pen-based computers. Although the market was not ready for the pen-based computing idea a spin off from the Ink Development venture showed more promise.

The software tools that Omidyar and partners developed facilitated online commerce. The company was turned into a retailer of electronics called 'e-Shop'. Although retaining his share of the business, by 1994 he had left to work in developer-relations for General Magic, a mobile-communications start-up company. In 1996 Microsoft bought out e-Shop making Omidyar a millionaire before he turned thirty.

It was during his stay at General Magic that Omidyar created 'AuctionWeb', the first tentative steps towards creating an online marketplace. He had an ambition to create the perfect market and believed the internet was the ideal mechanism for making this happen. His timing coincided with the first wave of excitement created by the commercialisation of the internet in the mid 1990s. Many academics, entrepreneurs and technologists spent a great deal of time and energy thinking up the 'killer application' that would harness the power of the new medium for communication to create an entirely new and lucrative business. This period saw the emergence of Amazon.com (online bookselling) and Webvan (groceries) as early-movers in the e-commerce environment. Many others quickly followed, some survived, many did not.

Omidyar decided that his application would be based on the auction model where people could come together electronically to reach an agreed price for a transaction. Since the venture remained a hobby rather than his livelihood he decided to offer the service free. The initial program that Omidyar wrote allowed users to do only three things – list items, view items and place bids. It was during this period that he gained proprietorship for his web-based consultancy and freelance technology work and called it 'Echo Bay Technology Group'. However, when it came to registering the name he discovered that EchoBay.com was a domain name owned by a Canadian mining company. He decided on the abridged version called e-Bay.com and an internet legend was born (Cohen, 2002).

The AuctionWeb site was one of several that ran on the e-Bay home page but it took some time for it to register even a few clicks of interest due to the lack of publicity afforded it. The only advertising it received was on Usenet newsgroups that listed new websites. However, by the end of the summer of 1995 the first trickle of interest emerged with an eclectic mix of goods appearing for auction on the site. These included computers, posters, toys, underwear and a host of items that could generically be called 'bric-a-brac'. The trickle grew into a steady flow and the value of items began to widen in range from a few cents through to thousands of dollars.

Importantly, AuctionWeb was gaining in prominence through that tried and tested marketing technique – word-of-mouth. By the end of 1995 the site had attracted more than 10 000 bids. What turned AuctionWeb from a hobby into a business was the site's Internet Service Provider deciding to charge a fee for access based on commercial rates. The approach Omidyar took to covering the charge was to introduce final-value fees. This would be a percentage of the agreed sale price. The charging of fees did not seriously harm the business as Omidyar had feared and soon the cheques started to arrive on his doorstep. In the first month of charging fees the website earned more than the ISP charge, thereby making it almost unique in internet start-up history by registering a profit right from the first month of trading.

From early 1996 onwards the popularity of the AuctionWeb site continued to grow. Omidyar knew he had a viable business but believed that the auction-based model would eventually be imitated by larger companies, such as AOL. His long-term view was that the core business would swing more towards the licensing of software. However, the auction site continued to grow.

Previously, Omidyar had recruited entrepreneur Jeff Skoll to manage the strategy, but as the business grew out of all proportion to expectations they decided to seek advice and funding from Benchmark, a venture capital company run by Bruce Dunlevie and Bob Kagle. Initially, the two prevaricated on backing Omidyar but two factors brought them round.

First, the idea of bringing people together to haggle over a transaction was the purest form of entrepreneurship. Second, and more importantly, though, was the sheer numbers of people that were being attracted to the site. In the first few months of 1997, traffic on AuctionWeb was so heavy that it gained the nickname the Great e-Bay Flood. From gaining a quarter of a million hits in the whole of 1996, AuctionWeb was attracting over one million hits in a single two-week period in January 1997. The Benchmark team were persuaded to invest $5 million for a 21.5% share of the business. The investment is now worth over $4 billion.

One of the measures taken by Omidyar after seeking the advice of Dunlevie and Kagle was to maintain the consistency of the brand by dropping AuctionWeb in favour of the now world-recognised name of 'e-Bay'. The company is now the most widely recognised and most successful internet business in the world. E-Bay operates in thirty-two international markets, has 135 million registered members who buy or sell goods worth $1050 every second from over 34 million items listed. The company has a turnover of $34 billion per annum, 95% of which is generated from small businesses or individuals. Although the site attracts some notable big money transactions and is used by leading corporations, such as Vodaphone and IBM as a way of disposing of excess stock, the majority of transactions are for less than $50 thereby making e-Bay a classic example of a long-tail business (see Chapter 4).

The mission of e-Bay

The mission of e-Bay is a statement of intent that reflects the philosophy of founder Pierre Omidyar in creating the perfect market. Trust lies at the heart of the e-Bay concept and much depends on the goodwill and honesty of the 'community' of buyers and sellers. Omidyar believes that creating a transparent, open and free market will drive away the relatively few traders who exploit the system dishonestly. One means of doing so is the creation of the feedback forum where users can offer opinions on all aspects of the e-Bay trading experience. Using the forum, users can rate the experience of buying or selling with another trader. Ratings are simply defined as positive, negative or neutral with a space for additional comments. The feedback is available to all who access the website. Essentially, the traders self police the website by bestowing credibility on honest traders and exposing the dishonest ones.

How it works

The e-Bay system of online auctions is simple, effective and capable of generating huge sums of money for the company. It also provides a cheap and easy way for users to make money on items they no longer want or to access products they seek. The e-Bay site also provides a facility for many different kinds of businesses to sell their products. The e-Bay auction site works by bringing buyers and sellers together electronically to effect transactions. Sellers place an item on the e-Bay list and set a reserve or fixed price for the product. Interested buyers then bid for the product and the highest bid is accepted. Buyers pay the price of the item as well as delivery charges.

Traditionally, sellers provide credit card details so that e-Bay can charge a fee for listing their product. However, since 2005 e-Bay has made participation easier by allowing conventional banking arrangements. Nevertheless, the majority of fees are gathered via credit cards. In the UK, fees range from 15p for items under £1, to £2 for items over £100.

There are extra charges for sellers who wish to update or upgrade their product listing. For example, a listing on the home page costs £49.95 (2005 rates). Setting a reserve price is a further 2% of the price chosen. Extra fees are then payable when the item sells. Sellers determine the length of their auction and the postage costs. Reserve prices are given to ensure that the seller makes at least enough to cover the listing costs. Some sellers will place an item on a fixed cost basis to secure a quick sale.

The electronic payment system used by e-Bay is PayPal (a company specialising in secure payments encryption acquired by e-Bay) and there is a further charge of up to 3.5% for that. If an item fails to sell it can be listed again for free. When it finally sells, e-Bay charges a final value fee of 5.25% of the first £30, plus 3.25% for products up to the value of £600 and 1.75% of any remaining value.

Very often it makes economic sense for sellers to set high postage costs. From the total income gained from the sale of an item a seller pays for overheads, the cost of the item and fees to e-Bay. By setting a high postal charge sellers can set a *de facto* reserve price. It also helps sellers avoid e-Bay charges since these relate to the start price, the sale price and on the reserve price (if the seller sets one). No charge is set on postal costs. For example, if an item is sold for £10 but the postage is set at £100 the seller only incurs charges for the £10. As for buyers, they need to ensure that they are paying a realistic price for any item they intend to purchase regardless of how the costs pan out. The principle of *caveat emptor* is as valid in cyberspace as it is in the real world.

e-Bay in the USA

There are some staggering statistics relating to the phenomenon that is e-Bay. In 2005, the company had 150 million registered users worldwide, 60 million of whom are termed 'active users' in that they have bid for an item within the previous twelve months. Wherever there is internet connectivity there is sure to be buying and selling activity taking place using the e-Bay website.

However, it is the US market that is the powerhouse driving the 'e-Bay economy'. The company accounts for around 25% of all e-commerce sales in the US and around half a million Americans make their living by trading on the company's website (*The Economist*, 2005). There is a vast array of goods traded on the e-Bay site, but the US market is distinctive for a number of reasons. For example, no other country has used cars as the most valuable category, or has as many fixed prices as a proportion of all items listed (30%). Fixed prices have given a boost to several markets including sales of clothes and accessories.

Perhaps the most striking feature of e-Bay in the USA is the relationship the company has with the thousands of traders that rely on the site for their livelihood. For professional traders the e-Bay website is not simply a platform for having fun trying to sell an unwanted toy or family heirloom, but is the trading floor for their business. When e-Bay increased fees in 2005 there was a great deal of protest from professional traders. The rationale for the increase was to balance the market and introduce clearer differentiation between standard listings and optional features that users pay extra for.

The disquiet over fees and the lack of effective dialogue between traders and e-Bay management has seen some disgruntled sellers seeking other sites. Although this represents a trickle not a haemorrhage, the company is sensitive to users' changes in trading habits. This is especially true when monitoring the share price and the operating profits. Whilst e-Bay broke through the $1 billion profit barrier in 2005, the rate of growth of the business showed the first signs of slowing by the third quarter of 2004.

Figure CS2.1 illustrates the share price of e-Bay since 1998 and Figure CS2.2 illustrates the profits made by the company over the same period.

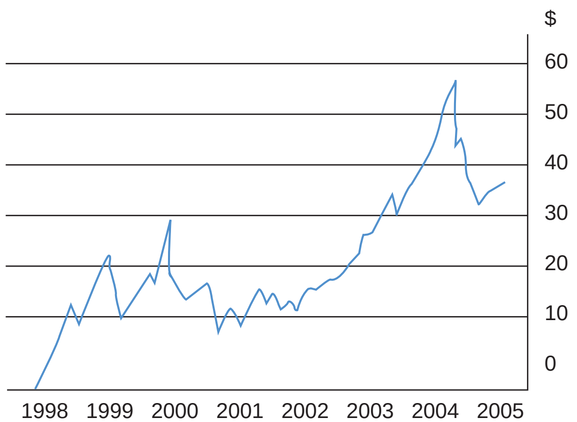

Figure CS2.1 e-Bay share prices ($) 1998–2005. Source: *The Economist*, June 11, 2005

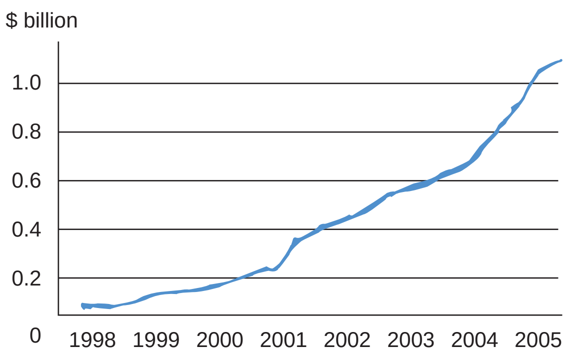

Figure CS2.2 Profits of e-Bay ($). Source: *The Economist*, June 11, 2005

e-Bay in the UK

The phenomenal growth of e-Bay in the United States has been mirrored in the UK. The website has around 10 million registered members in the UK and is achieving growth rates of 160% per annum.

The site continues to attract thousands of new users every month. The UK now represents the third biggest market for e-Bay behind the US and Germany.

Perhaps the most striking statistic is that about a third of all UK internet users access the e-Bay website each month (Rowan, 2005). Most are either buyers or sellers and a significant number access the e-Bay chat room to discuss their experience of using the site or to swap stories relating to particular transactions and other related issues. However, for around 10 000 people in the UK the e-Bay website is their livelihood. Most use e-Bay as their 'shop window' to sell products, others advertise their services and a growing number have transformed their hobby into a business by providing advice or selling products and services relating to their particular interest.

Managers at e-Bay in the UK believe that there is much more growth to come in future. There is, for example, a huge market for second-hand cars, office equipment and industrial components. To leverage maximum advantage from these and other markets e-Bay has made it easier for businesses to use its site by facilitating conventional banking arrangements and personalising customer service.

Expansion of markets and services

The popularity of e-Bay has grown steadily around the globe since its inception in 1995. However, in the face of increasing competition from Yahoo! and Amazon.com, both of whom have set up auction sites to rival e-Bay, the company has had to expand globally to maintain its level of growth and to broaden the customer base.

The website is well established in Europe, with Germans leading the way with 12% of all time spent on the internet being dedicated to browsing or using the e-Bay website. Expanding into the German market was achieved by acquiring Alando.de, a German version of e-Bay that had been building an impressive customer base since its inception in 1999. In the first two months of trading the company achieved around a quarter of a million items sold and registered 50 000 users. The growth of the business attracted e-Bay executives and in 2000 Alando.de was absorbed into e-Bay, albeit with a distinctly German culture remaining in tact.

Other areas of expansion include Australia, where e-Bay launched in 1999 and leads the market, Canada and South Korea. However, the internationalisation of e-Bay has not been all plain sailing.

The venture into the Japanese market proved painful as rivals Yahoo! stole a march on them by setting up an auction site five months earlier than e-Bay and attracting around two million listings compared to a paltry two thousand for e-Bay. The company failed to understand the distinct cultural factors that characterise the Japanese market. For example, sticking to company policy by charging fees was a mistake since the Yahoo! site was free. Also, customers could only pay by credit card on e-Bay, but few Japanese own a credit card. The combination of these factors led e-Bay to withdraw from Japan in 2002.

In future, e-Bay is set to expand into the lucrative Chinese market. Chief Executive, Meg Whitman, sees China as becoming e-Bay's biggest market by 2015. The company has committed $100 million to promote the business in China for five years from 2005. Although rates of growth have eased in the USA, the company expects new markets in Asia to make up the difference with some to spare.

The company is already investing in the skills and expertise required to make the e-Bay experience culturally and socially relevant to users in different parts of the globe. This means thinking through service provision more carefully. The old adage of 'think global, act local' still has a resonance with companies seeking a foothold in countries such as China, Malaysia and Japan.

The expansion of services has been one of the key elements of the e-Bay strategy. The company has developed new services such as business listings and 'pay-per-click' advertising services as well as acquiring other companies that can add to the service portfolio. Acquisitions of companies such as payments specialists 'PayPal' and shopping comparison site 'Shopping.com' have extended the services to users, and brought benefits from the synergy of specialist activities and the core activity of e-Bay that is bringing people together for trading purposes.

Security

Security is often viewed as the achilles heel of the internet. In the United States in 2003/4, reported consumer losses due to fraud amounted to $200 million, half of which involved online auctions (*The Economist*, 2005). Companies are also victims of fraud and other types of security breaches, although the true cost is unknown due to the reluctance of organisations to reveal the extent of the problem. As noted earlier, the e-Bay concept is based on a high degree of trust between buyers and sellers. Whilst the vast majority of transactions are legitimate and generate high satisfaction ratings, the system is open to abuse by criminals and others with malicious intent. The company employs nearly 1000 people around the globe whose job is to police the website and identify any suspicious or damaging activity by users.

Incidents of fraudulent behaviour on the website are bad news for e-Bay since they inevitably undermine consumers' confidence in the system. The ease of access and use of the internet has attracted rogue elements. A judge in the UK criticised the e-Bay website for being an 'open shop for fraud' after presiding in a case that involved a woman selling non-existent tickets for the Glastonbury music festival to unsuspecting buyers. Sellers too can be victims of fraud. Computer hackers can steal someone else's identity, put in a winning bid and receive goods before the scam is detected. In such instances, e-Bay, through their payments arm PayPal, will only compensate losses up to £105.

One of the most common forms of fraud is so-called 'phishing' where victims are duped into visiting bogus sites and divulging private information (passwords, credit card details, etc.) after receiving fake e-mails. To combat 'phishing' e-Bay has launched 'My Messages', a private messaging service. 'My Messages' is a read-only inbox for subscribers logged into the e-Bay website. This ensures that any messages subscribers receive in their own inboxes purporting to be from e-Bay are fakes.

Critics point out that if such private e-mail services proliferate then the convenience of using e-mail will be diminished as users have to access messages via numerous commercial sites (Young, 2005). Others suggest that it may attract 'phishers' to the e-Bay site. The use of 'Tojans', software that tracks keystrokes, is increasingly used for 'phishing' expeditions by fraudsters and the private inboxes provided by e-Bay could be a target.

In some instances buyers can be duped into paying more for items than they retail in shops. Although this does not constitute fraud, it is against the spirit and ethos of the unwritten rules of trading on e-Bay. The items that feature mostly in this sort of unscrupulous activity are CDs, computers and mobile phones. Often dealers will put in spurious bids to initiate a price hike for an item.

To protect the reputation of the business, e-Bay has had to take measures to minimise the number of items listed that are either illegal (guns and other deadly weapons, controlled drugs, terrorist manuals) or immoral (certain types of pornography). In 1999, a seller listed one of his kidneys as an item for sale with a reserve price of $25 000. The bidding reached $5.7 million before e-Bay removed the listing and declared it a hoax. It also violated both company policy and federal law relating to the sale of body parts in the US.

In the UK, the e-Bay UK site has taken action to end the auction of a semi-automatic CZ75 pistol. However, the Association of Chief Police Officers (ACPO) has issued warnings that increasing numbers of weapons are appearing on the e-Bay site in the UK. The problem facing e-Bay is the sheer volume of listed items that appear at any given time. Items such as guns are likely to only appear for a 24-hour period before being snapped up by criminals. This makes detection and eradication difficult for e-Bay.

There are measures that users of e-Bay can take to protect themselves from being victims of fraudulent activity. These include:

- Check out the seller or buyer through feedback from other users;
- Do not bid too high since sellers can get agents to bid on items to artificially raise the price;
- Establish whether or not the item bid for is insured;
- Find out where the trader is based;
- Do not pay by money transfer services, pay by credit card or via PayPal accounts.

Occasionally, e-Bay is confronted by ethical questions relating to trading practices. One such example was the auctioning of Live8 tickets on the website by people who were lucky enough to have obtained a ticket through the lottery system operated by the organisers of the highly popular musical event. Although the sellers were doing nothing illegal, the practice called into question the ethical issue of gaining monetary reward for a cause intended to highlight poverty in Africa. Managers at e-bay came under pressure from the event organisers, most notably Sir Bob Geldof, to ban the auctioning of Live8 tickets on the website.

Although most people would agree that such a practice is morally reprehensible, it does highlight the dilemma facing e-Bay. Their mission is to bring people together for trading purposes in a spirit of free market enterprise. As noted previously, illegal or immoral trading is actively discouraged by e-Bay. The dilemma is where to draw the line between trading items for monetary gain where there is an ethical dimension to the transaction. Some would argue that in a truly free market environment it should be left to the conscience of the trading partners to determine whether or not the transaction takes place. However, in the case of the Live8 tickets, e-Bay stepped in to ban their auction on the website. Critics argued that the company had compromised their free market ethos to escape the negative publicity surrounding the issue.

Tax

The high profile of internet firms such as Google, Yahoo! and e-Bay has attracted the attention of the tax authorities. Online auctions are of particular interest because of the large amount of undeclared income that the websites generate for sellers. In the UK the tax authority is the Inland Revenue (IR). Although a strategy for dealing with tax evasion from goods sold online has yet to be established, the authority is looking at ways of tightening the gap in the law pertaining to online sales.

In the first instance, the IR has been engaged in discussions with e-Bay to develop educational programmes for users of their website so that they become aware of their tax obligations. Agreement has been reached regarding the placement of links on e-Bay to relevant pages dealing with tax on goods sold online on the web pages of the IR. The UK government is also seeking ways of making the tax system fairer and is committed to tackling tax evasion both offline and online.

The thousands of people who use e-Bay as a trading platform have tax obligations since anyone who buys goods with the intention of selling them on (trading) will be liable to pay tax on any profits made. However, users of e-Bay or any other auction website who sell unwanted items online are not liable to pay tax unless the profits generated exceed £6000.

The future

While it is difficult to predict the future shape of the industry that e-Bay inhabits with any certainty it seems clear that the big players in the internet arena, such as Amazon.com, Yahoo!, Google and AOL, will follow a similar strategy to e-Bay by expanding internationally (especially in China) and in the number of differentiated services they provide. It is likely that sometime in the next decade e-Bay will evolve into a portal for servicing a wide range of demands from a huge and diverse customer base. Being first to market with new, innovative and differentiated services that clearly add value to customers will determine who the winners and losers are in the fiercely competitive internet environment.

Each of the internet heavyweights has its own strengths and weaknesses but e-Bay has the sheer numbers of loyal users who generate vast sums in repeat business as their main competitive advantage. The company is a truly global business phenomenon and continues to rack up more and more users as each month passes. Although the rate of growth may slow, the economies of scale in servicing such a huge customer base mean the company is well placed to dominate for years to come.

Key issues:

Main strengths of e-Bay:

- First-mover advantages in online auction market;
- Global brand awareness;
- Network externalities created by developing a community of buyers and sellers;
- Brand loyalty of buyers and sellers because of quality of service;
- Economies of scale from huge customer base;
- Profitable from first month of trading;
- Acquisition of specialist firms to create synergy and provide value-adding and differentiated services;
- Conservative management style.

Main weaknesses:

- Managing expansion into key markets such as Japan;
- Communications with professional traders who are reliant on the e-Bay website;
- Understanding cultural differences in foreign markets.

Main opportunities:

- Expanding services;

- Expanding internationally, especially in the growth markets of China and India;
- Forming alliances with other firms to manage expansion.

Main threats:

- Security breaches and fraud;
- Intensity of competition;
- Pressure to meet expectations of shareholders, stakeholders and customers;
- Pressure to maintain growth rates;
- Pressure to maintain profit levels;
- Retaining key management personnel.

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Tesco.com

Introduction

Supermarket giant Tesco was founded in the aftermath of the First World War in 1918. Jack Cohen used his army discharge money to set up a grocery stall in the East End of London. The first Tesco store opened in 1929 and a UK retailing institution was born. Throughout the rest of the twentieth century Tesco continued to grow, with the number of stores opening increasing year on year.

The philosophy of Tesco was to sell a wide range of quality products at reasonable prices. There was an added convenience factor for consumers by ensuring that a Tesco store was located within easy reach of the majority of customers. Stores were opened in many urban and suburban areas throughout the UK. The company proved profitable because of the economies of scale associated with buying in bulk and selling at high volume. This also meant that costs were kept low. By the early 1970s Tesco was a major presence on the UK retailing landscape and maintained the philosophy of selling basic groceries at low prices. Indeed, the knighted Sir Jack Cohen recognised this overriding philosophy by naming his autobiography *Pile It High, Sell It Cheap*.

The 1980s saw Tesco continue to grow and expand its products and services. Greater emphasis was placed on the physical environment of the stores and the management of Tesco sought out knowledge on the psychology of shopping from experts around the globe. The non-food element of the business took on more importance as the company sought to bolster the brand image and build on the already significant brand loyalty it enjoyed. The strategy of becoming as strong in the non-food sector as it was in the food sector was one of the key aims of the company into the 1990s. Alongside expansion internationally, the way Tesco sought to improve services to customers was identified as providing financial services and information and delivery services via the internet.

Tesco benefited from having a customer-focus to its operations. This was evident in a number of different ways. The 'One in Front' initiative was designed to ensure that queues of customers did not exceed two at any checkout. Although it cost the company many millions of pounds to implement, the plan worked since customers appreciated the quick and efficient service provided. Tesco was also a first-mover in providing loyalty cards in the UK. Launched in 1995, the loyalty cards rewarded customers for shopping with Tesco. By 2000 there were nearly ten million Tesco Clubcard members throughout the UK. The company has built on its success and has been Britain's biggest retailer since the mid 1990s.

In 2005 Tesco broke through the 30% market share in the grocery market for the first time. The company was also the first UK retailer to register profits of more than £2 billion. This is hardly surprising given that for every £8 spent by UK consumers, £1 will be spent in Tesco. Part of the reason for the success of Tesco has been the ability of the managers at the company to determine exactly what their customers want and provide it quickly, efficiently, conveniently and at low cost. The company has been able to draw customers away from rivals whilst consolidating their grip on the loyalty of their existing customers.

Tesco has been able to use the value of the brand to enter the financial services market successfully. Where rivals have struggled to make much impression against traditional financial services retailers, Tesco has used the brand effectively to offer a range of services such as savings accounts, travel and motor insurance, and loan facilities. There has also been an internet mortgage-finder service. A partnership agreement with the Royal Bank of Scotland ensured that customers received a quality service that they could trust. However, one of the most risk-bearing and adventurous initiatives adopted by Tesco was to be first-movers in the online grocery delivery sector in the UK.

Tesco online services

In 1995 Tesco began offering online services based on customers making orders from their local Tesco store using the internet. The company also launched their own Internet Service Provider (ISP), Tesco.net, as a means of linking the online delivery service with internet access facilities. This provided customers with a greater choice of ISP. Since the existing stores, warehouses and distribution networks were already in place, the initial investment for the online service was relatively small. The company spent around £25 million getting the online service up and running throughout the UK.

The Tesco.com online service is simple and convenient for consumers who are willing to pay extra for having their groceries collected and delivered to their door. Orders are taken and processed online and the information sent to the nearest store to the consumer. Tesco stores have a number of staff known as 'pickers' who gather together the items on each list sent online. The groceries are then assembled at a delivery point and distributed to households within a given area during a given timeslot. Tesco gives approximate times within the timeframe for delivery so that consumers can ensure that someone is home to collect the goods when they arrive. Most payments are undertaken online too. Crucially, each Tesco store could update information on prices, what items were available and their sell-by date. Where items are unavailable the 'pickers' will include a close substitute.

Everyday grocery items such as bread, fruit, vegetables and milk are the most popular items bought online, but Tesco.com also report a healthy online demand for non-food items such as CDs, videos, electrical goods and books. The convenience factor is the biggest driving force behind the demand for online delivery. The company has developed sophisticated software to help manage the collection and delivery of the goods to customers.

There are also a number of marketing benefits associated with developing the online service. The information derived from the database of customers helps Tesco determine what products are in high demand; what products require specific types of marketing and promotion; and when, and for how long, customers interact online and what they want. The information derived from this database also provides Tesco with feedback on satisfaction rates and responses of customers to new offers or products. The bank of information helps Tesco to hone their online strategy and deliver an added-value service to customers by responding to what they want.

The online service helps the company to form more intense relationships with customers through offering a more personalised service. For example, the company has collaborated with software developers to tailor web promotions of products that individual customers habitually buy. It also advertises complementary products or related products to those habitually bought by individual customers. Customers perceive an added value to the personalised characteristics of the advertising campaign. This is much more effective than generic advertising because customers are more responsive to promotions that interest them.

By 2001 Tesco.com had one million registered customers making it the biggest online grocery service in the world. Although profits from the venture remained elusive for the first few years of its operation there were a number of other advantages the service brought that would serve Tesco well in future. The marketing benefits were already becoming clear by the late 1990s.

The online service helped to broaden the appeal of the brand to new customers, especially younger customers. The first-mover advantages meant that Tesco had a head start in the learning process of operating an online service compared to its rivals. There were links between the online and offline service provided by the company, such as the extension of the Clubcard loyalty scheme and access to discounts. The Clubcard loyalty scheme was relaunched to reflect different levels of spending by customers. Customers were allocated either gold, silver or bronze status according to their spending habits. This is available to online as well as offline shoppers.

By 2005, Tesco.com was available to 98% of the UK population through the distribution network working from over 350 stores. No other UK supermarket could compete with the service provided by Tesco. Indeed, such is the company's dominance of the UK supermarket sector that there have been some calls for government to step in and limit their continued expansion. In particular, small-scale grocery retailers have complained that Tesco have squeezed them out of the marketplace.

Competition

Tesco were the first-movers into the online grocery services in the UK. The company has built up a significant lead over other supermarkets and retailers and used the brand effectively to attract new customers. The company claim that around a third of their online customers have never shopped at Tesco before (MyWebGrocer.com). If this is the case, then the online service has been able to attract a new kind of shopper – one that is more likely to use the internet for many of life's transactions and services.

Among the closest rivals to Tesco, both ASDA and Sainsbury's have online services. Initially, ASDA rolled out a service based on giving

CD-ROMs to customers that could be used to order from a select number of items. ASDA would update the CD-ROM periodically with changes to prices and products available, as well as information on special offers and promotional campaigns. However, the system proved cumbersome and unpopular with customers.

In 2001 the company rolled out their internet-based order system called ASDA@home. Although the online service proved more flexible and effective than the CD-ROM initiative, the service was only available in a very limited number of locations. ASDA did not have anything like the number of stores around the country that Tesco had and this limited their ability to distribute groceries in key locations. However, where the service was available ASDA offered a free delivery for orders exceeding £99, something Tesco had not considered.

Sainsbury's is the nearest rivals to Tesco but was slow to develop an online service. It was only after former Prudential boss Sir Peter Davis took over that the company took the online service seriously and backed it with significant investment. Sir Peter saw the benefits of the internet after successfully implementing an online strategy for delivery of financial products in the insurance industry.

Although the company is still playing catch up with Tesco for market share of online services, giant strides have been made. The company can now service over 70% of the UK for online delivery services. Also, like Tesco, the company has been able to extend the reach of the brand using the internet. In particular, the 2004 marketing campaign focusing on price cuts across a range of products was a central feature of the promotional campaigns used on the website. The online service is likely to become an increasingly important channel for Sainsbury's in its pursuit of market share in the highly competitive supermarket industry.

Pricing policy of Tesco.com

The pricing policies of firms selling products and services via the internet has attracted the interest of various bodies including, in the UK, the Office of Fair Trading (OFT) and, in the EU, the European Commission. The OFT has been active in investigating some of the UK's biggest supermarkets following allegations of overcharging. Both Tesco and Sainsbury's have been accused of charging higher prices than are advertised on their websites; charging for a premium product and supplying a regular product; charging more for online products than those in-store; and using websites to offload food close to its sell-by date (Winnett and Leppard, 2004). The OFT is also investigating the high number of customers who have reported deliveries falling short of those ordered.

Many of the problems stem from the website content of supermarkets. Consumers believe that the information on websites relating to prices and availability of goods is a definitive account. Although Tesco could benefit from introducing dynamic pricing for its products sold online the company has yet to adopt this strategy. The websites offer only a ‘guide’ to prices and availability. The websites are not ‘real-time’ and very often do not provide up-to-date information on prices and availability. Where ordered products are unavailable, the supermarkets will deliver ‘an appropriate substitute’. Just how ‘appropriate’ is often a bone of contention between supermarkets and customers.

Another regular complaint centres on the delivery slots available. Typically, Tesco makes twelve deliveries per van during each 4-hour shift (Finch, 2001). There are particular slots during the day when demand for deliveries is high. It is not always possible for Tesco to deliver to everyone in the slots they want. Customers may have to wait until later slots, even into the night, before receiving their deliveries.

Tesco has to weigh up the difference between investment in more vans and distribution costs with the prices charged and the level of demand. Nevertheless, if customers are unable to gain deliveries of their groceries when they want then, from their perspective, the convenience and speed of the online service has failed. This may have a detrimental effect on customer loyalty, although Tesco reports high levels of customer satisfaction overall. Online shopping is becoming an increasingly important aspect of the company’s activities. However, there is a gap between consumers’ expectations and fulfilment that needs to be addressed.

Effective use of the internet by Tesco

Tesco uses Information and Communications Technology (ICT) to help manage its operations. In particular, its extranet has been an invaluable tool in managing relationships and operations with its suppliers. Traditionally, supermarkets have restricted the type of information they give out to manufacturers and suppliers for operational reasons. Since the development of the extranet, however, the benefits of sharing knowledge have become apparent to companies such as Tesco. Crucially, the extranet allows Tesco control over who has access to the information.

Efficient Consumer Response (ECR) is a technique that encourages information exchange between retailers and manufacturers and is the basis for co-operation between the two parties for mutual benefit. The key areas of operations that ECR is designed to improve include store assortment, re-stocking, marketing and promotion, and new product introductions.

In 1998, Tesco developed their own system called 'Tesco Information Exchange' (TIE) and linked it with half a dozen of their suppliers. TIE allows the sharing of information on Electronic Point of Sale (EPOS) data, stock movements, the introduction of new products and the latest marketing campaigns. The system also features directory services of stores, key personnel and general in-house news. However, the system for information sharing incurs a cost that has to be covered. The system is run by a third-party company and suppliers have to pay a fee for access to the information. The fee is dependent on the volume of business the supplier has with Tesco.

Tesco has built up a huge database of information on the socio-economic profile of customers and their spending habits. The company employs data analysts to search for trends or pinpoint opportunities that underpin supply chain management and the marketing effort.

So-called 'data mining' is a technique geared towards searching for correlations that offer valuable insights into customer behaviour. This, in turn, helps inform the buying and marketing strategies of Tesco. Each market segment will be subjected to data mining and analysis to determine the trends in buying behaviour. For example, through analysis of data, Tesco discovered that those people who shop online are more likely to buy financial products from the company than offline shoppers. This led to an increase in the marketing effort for their portfolio of financial services offered to online customers.

Tesco has also been actively engaged in developing artificial neural networks. This technology is designed to let computers solve problems by recognising trends in data. The technology takes over some of the roles previously played by humans in identifying trends. Artificial neural networks are programmed to recognise previously recognised trends and to adapt responses according to those trends.

The 'learning' from previous problems and solutions is an in-built capability of the computer and allows it to offer new solutions to new problems. The capability of the computers to detect trends from a vast amount of data far outstrips human capability. This not only increases the bank of relevant knowledge that the company has, but also provides that knowledge much more quickly and efficiently.

Furthermore, the system can be tailored to focus on all buyers, groups of buyers or even individual buyers. Tesco has used artificial neural networks to discern patterns of buying behaviour across a wide range of different products in different regions by different socio-economic groups. For example, the system was able to highlight differences in tastes of crisp buyers across different regions of the UK. This helped inform managers of stock requirements for particular flavours of crisps and led to reductions in excess capacity and better use of shelf space for those particular products.

Information technology and the internet also help Tesco develop pricing strategies. The data gathered on customers helps the company to understand buying habits and tailor supply accordingly. The information is crucial for linking pricing to particular target markets and helps to underpin the competitive position the company seeks to adopt in the marketplace.

The information gathered also extends to distribution and manufacturing costs. These costs are linked to levels of consumers' demand for particular products to determine a pricing strategy that creates a suitable margin of profit for the business. Analysts are also employed to track responses to price changes. Again, technology can help in identifying changes in demand in response to changes in price. An elasticity curve for price changes graphically represents the responses of customers to changes in price and managers can respond appropriately to the changes in buying behaviour. Importantly, the information allows the company to set optimal prices for each individual product sold to maximise margins and profits.

The data gathered by Tesco on consumers' buying habits not only informs them of past consumer behaviour but also provides the basis for making accurate forecasts of future buying behaviour. Most humans are creatures of habit and it is possible to identify fairly accurately what people will buy on each visit to the shop. Shopping habits rarely change and can be identified accurately over a period of time. This again helps Tesco in supply chain management, marketing and promotion, shelf-space capacity, the store layout and a host of other factors that determine efficient store management.

Tesco also operates an effective intranet for employees and management. The intranet provides a communications channel for any Tesco staff member to access to put forward suggestions or comments regarding any aspect of work within the company. The intranet provides an ideal channel for management to communicate ideas and directives to staff and to explain the rationale for changes in the management of stores. The intranet supplements face-to-face communication between management and staff and reinforces important messages. The intranet also hosts a wide range of in-house news featuring job vacancies, performance reviews, promotional campaigns, customer feedback, management changes, work regulations, health and hygiene issues and many others.

The internet has played a role in determining where Tesco locates its stores. Geographic Information Systems (GIS) provide 'intelligent maps' of locations including information on road networks and the location of rival stores (O'Connor and Galvin, 2001). From this information Tesco has been able to make decisions on the precise location of their stores. Factors that are taken into account include the drive time from the main residential areas surrounding the proposed site, the population density and the performance profile of the local economy.

Tesco has an agreement with Ordnance Survey for the provision of digital maps of areas designated as possible sites for locating stores. Information on road driving conditions and times on particular routes are provided by the Department of Transport. The census is a useful source of information on population density and socio-economic profiles in particular regions. Research by Tesco has revealed that most people do not want to drive for more than fifteen minutes to a supermarket. The company has also determined the minimum population density required to justify investing in a new site location.

Summary

Tesco was one of the first supermarkets in the world to take advantage of the internet to add another channel of communication and trade with customers. The first-mover advantages gained by the company in providing online services have enabled Tesco to gain and sustain a competitive advantage in online services. The initial costs of setting up the online service were relatively low because Tesco already had the network infrastructure in place to help them meet stringent distribution and delivery targets.

The internet and related technologies have also been used effectively in helping the company better understand its customers. The huge amount of information on the shopping habits of customers has proved invaluable to Tesco when managing their supply chain and designing marketing and promotional campaigns. Analysis of buying trends reveals likely demand conditions for each product, which helps save costs by maximising use of shelf space and optimising capacity in stores. Meanwhile, the use of the company extranet helps to manage relationships with a wide range of different suppliers. Internally, the company intranet provides a useful means of communication between all employees and management at Tesco stores.

Technology has played a key role in helping Tesco become the UK's biggest and most successful supermarket. The company enjoys a significant lead in market share and this is reflected in the year on year increases in profits reported by the company. ICT and the internet have enabled Tesco to:

- Better understand its customers;
- Manage demand and supply conditions effectively;
- Save on costs;
- Create better target marketing and promotion campaigns;
- Deliver quality service;
- Underpin overall strategy, including the location of stores throughout the country.

The combination of all these advantages has enabled Tesco to build a huge brand loyalty among large numbers of customers and this has been translated into a sustained competitive advantage over rivals.

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CASE STUDY 4

Yahoo!

Introduction

One of the common characteristics of internet pioneers is the high level of intelligence they possess. Pierre Omidyar of e-Bay, Marc Andreeson and Jim Clark who developed Mosaic and Tim Berners Lee, the developer of the World Wide Web, are all academic achievers. The internet has attracted some of the best intellectual minds across the globe, with the epicentre of the technological revolution being Silicon Valley in California.

The inventors of search engine Yahoo! fitted into this profile perfectly. Jerry Yang and David Filo were two Stanford University PhD students who amused themselves by building lists of web addresses in-between writing their theses. Their hobby grew into a multi-billion dollar global business. However, like their counterpart Pierre Omidyar of e-Bay, Yang and Filo did not develop their internet idea for entrepreneurial purposes. Each had an obsessive interest in computers and was motivated solely by what the technology could achieve. It was only when their ideas took form and phenomenal growth in demand followed that they considered the business opportunities.

Yang and Filo were very different personalities but complemented each other perfectly. The outgoing gregarious Yang was the human face of Yahoo! while Filo was the technology guru. Between them they organised their database of websites into 19 different categories including business, arts, computing, economics, education, and so on. There was a hierarchy of websites afforded to each category to ease the process of searching. This was significant because it would later form the basis of delivering advertising revenue from firms seeking exposure on the list, but also because it provided the basis for the brand name.

Yahoo! is an acronym for Yet Another Hierarchical Officious Oracle. The exclamation mark was added to further distinguish the brand. The Yahoo! site offers users quick and easy access to many millions of websites by creating links to different categories. Keyword software provides the first link and then each click on a heading leads to pages of related links around the subject matter. Crucially, the search behaviour of users could be logged and used as a basis for income generation. Information on where users had come from across different links and where they wanted to go was the basis for building an advertising revenue model. The information also allows the company to determine what is popular and most used. This acts as a guide to creating content.

The Yahoo! search engine was launched in 1993 and generated a few clicks of interest. However, by early the following year the clicks could be measured in thousands. By the end of 1994 Yahoo! had created thousands of web links and gained some 80 000 hits per day. It was during this initial growth period that Yahoo! received an important endorsement from industry pioneers Netscape. Netscape introduced a beta browser and decided to link the directory facility on its corporate website to Yahoo! This had the immediate effect of hugely increasing demand for the Yahoo! search engine. The company was registering around one million hits a day, enough to convince Yang and Filo that they had the makings of a significant business. The acquisitive overtures made by industry giants AOL among others merely served to confirm this.

The rise of Yahoo!

By 1995 Yahoo! was the search directory of choice for millions of internet users. The numbers all added up to a significant sized business. Yang and Filo sought venture capital to take the company to a level where they could compete effectively with established media companies such as Walt Disney and AOL. Ex-Motorola CEO Tim Koogle was appointed Chief Executive Officer and, after successful flotations by rivals such as Lycos and Excite, Yahoo! had an Initial Public Offering (IPO) on the NASDAQ (US technologies stock exchange) in April 1996. Demand for stocks immediately soared and the first day's trading saw their value increase by 150%. This meant that Yahoo! was valued at a staggering \$850 million with Yang and Filo each worth \$150 million.

The principle that access to the Yahoo! directory would be free survived the new management regime. However, this put added pressure on the need to gain revenue by other means, most notably through online advertising. In the frenzied atmosphere of the late 1990s few investors, entrepreneurs or internet pioneers gave much thought to the long-term implications of relying on the vagaries of the traditional advertising market, let alone the untested and untried online advertising market.

The high valuations placed on internet companies was partly due to the marketing effort put in to persuade investors of the benefits of online advertising. These included being able to better target specific groups of buyers through monitoring website traffic, personalisation of the marketing effort, cheap dissemination of messages, and building relationships with customers. The business model would be built around the number of internet users who ‘click through’ to access information on products and services after seeing a banner advertisement on a web page. The initial success of many internet companies including Yahoo! was based on the confidence of investors that increasing amounts of revenue could be generated through this business model.

The value and reputation of Yahoo! rose throughout the late 1990s as more and more investment funds poured into the internet economy. The company sought to expand its services and signed deals with key partners to facilitate this. The most important ones included a deal with Hewlett Packard for MyYahoo! to feature as the start page on all new HP Pavillion PCs from January 1999. This was quickly followed by a similar deal with IBM.

With revenues high, earnings per share rising and investor confidence booming, Yahoo! was one of the world’s most successful internet firms. Buoyed by the success of the business, CEO Tim Koogle set about expanding the Yahoo! business through acquisition. The first target was GeoCities, a provider of personal homepages. The site was the third most trafficked site on the internet in 1998 and attracted around 20 million unique visitors. Koogle believed that the combined power of the GeoCities and Yahoo! would give access to around 60% of American homes and attract advertisers like no other in the internet economy. The acquisition of Broadcast.com, an online audio and visual service provider, underlined the company’s determination to be seen as a global media company and not just a portal.

Although there were some signs that the internet economy was over-inflating and that some investors were expressing concerns (Japanese company, Softbank, the largest backer of Yahoo! sold three million shares to stave off losses for 1999), the management of Yahoo! remained confident in their advertising business model. By 1999 the company had amassed over 3000 regular advertisers. Many firms saw value in having their brand related to a globally recognised portal. Drugstore.com, for example, became partners with Yahoo! in order to guarantee advertising banner space for their healthcare products. Other firms followed this line of reasoning too and Yahoo! did not need to try too hard to attract advertisers during this golden period of the internet economy.

The new millennium started with the stock valuation of Yahoo! reaching a new peak of $237.50 giving a market capitalisation of $128 billion. Yahoo! was firmly established as one of the world's foremost media companies and one that had made a profit of almost $50 million for 1999. The firm was continuing to attract more and more unique monthly users (120 000 by December 1999 – double that of the previous year) and attracted around 3500 advertisers. Yahoo! was also beginning to penetrate international markets with around 13% of users being from outside the USA. However, despite the promising figures, all was not well in the internet economy and some of the deficiencies in the business models that underpinned the existence of dot-coms were beginning to unravel by early 2000.

The fall of Yahoo!

The online advertising model described above had some merits but the reality was very different from its potential. The 'click through' rates recorded never reached anywhere near expectations and there was growing evidence that internet users found banner advertising obtrusive and off-putting. The low level of interest in online advertising expressed by internet users made this form of advertising more expensive than traditional media such as newspaper advertisements and radio and television commercials. Nevertheless, confidence in this new media remained buoyant throughout the late 1990s. There was simply too much investment pumped into the industry to let it all deflate, so investors stayed true to a failing business model.

Everyone connected to the internet industry had a vested interest in its success and this economic fact served to prolong the mood of confidence even in the face of indisputable evidence that pointed to the industry being grossly overvalued and overhyped. For example, online publishing company EarthWeb had registered a loss of over $5 million in the first quarter of 1998. However, that economic fact did not deter investors from snapping up the company's stock when its IPO was announced. The stock valuation of the company rose by 250% in the first day of trading.

The IPO of online community TheGlobe.com was even more spectacular in its meteoric rise. Despite registering losses of $11.5 million by the third quarter of 1998, the company's share price rocketed from $9 to a peak of $97 before closing the first day at $63.50 – a rise of 600%. The market for internet stocks had spiralled out of control and was ripe for a 'South Sea Bubble' collapse.

The portents of doom were evident early in 2000. In February, many of the most trafficked websites, including Yahoo! and Amazon.com, were shut down for hours due to a series of 'denial-of-service' attacks. Surprisingly, Yahoo! had no back-up system to cope with what was a well-documented threat. Although the immediate effects of the attacks were manageable, the episode served to highlight the vulnerability of websites to determined attack. A fifteen-year-old Canadian boy was eventually convicted of the attack.

By early summer 2000 investors had clearly lost patience with the promises of profits from the internet economy. The figures relating to Yahoo! illustrate the change in mood. Even though the company continued to register increasing revenues, added more users to its portfolio and became the internet's number one portal, the stock price continued to slide. Investors were now only interested in the bottom line. Most worryingly, not only had the number of new advertisers slowed, but in the first quarter of 2000 the number had actually dropped by around two hundred. The first cracks in the design of the business model were beginning to emerge. The demise of prominent dot-coms such as boo.com, Pets.com and Living.com added to the sense of unease in the industry.

To bolster investor confidence and re-invigorate the business, Yahoo! undertook a management transformation and with it a fundamental change in philosophy. Henceforth, it was decided that Yahoo! would charge a fee for services. This was a high-risk strategy for the company because internet users were used to gaining access to content for free and with switching costs low the company risked losing brand loyalty. However, the move to charging fees was deemed necessary because the decline in banner advertisement 'click-through' rates by users was beginning to turn advertisers away from the internet.

The first sign that the internet economy was in serious trouble came in the form of a damaging articles appearing in weekly investment newspapers (Angel, 2002). For the first time financial journalists were writing about when the internet bubble would burst rather than if it would burst. This had the effect of concentrating minds on an issue that had been avoided – that the internet economy could not sustain the large number of firms that populated it and that very soon an industry shake-out would occur. The only way firms could survive was to be bought out by a larger more secure organisation, merge with a partner or find additional funding.

By mid April 2000 the selling of technology stocks on the NASDAQ was gaining momentum and no company was immune. Yahoo!, Amazon.com, Cisco, Microsoft and other technology and internet standard bearers were all subject to successive falls in share values. There followed a prolonged decline in stock market values of technology and internet firms culminating in the loss of some $2 trillion worth of wealth. The value of stocks for Yahoo! in the five-week period between March 10 and April 14, 2000, fell by almost 35%. It was not alone. Amazon.com registered a 30% decline in their stock value, TheGlobe.com 62.5% and e-Bay 27.9%. Throughout the rest of 2000 dot-coms disappeared from the scene as quickly as they had arrived.

The meltdown of the internet economy had serious consequences for Yahoo! and heralded a period of great turmoil for the company. The reliance on online advertising for the bulk of its revenue was the main weakness of the company. By 2000 it had become clear that this business model was not going to be sustainable and that a new strategy was required that focused on Yahoo! as a provider of multimedia services to a broad range of consumer and business clients. The moves that Yahoo! had already made towards being a media company rather than a pure dot-com probably saved the company from sliding into oblivion.

From mid 2000 onwards the emphasis of the company was to provide quality services and concentrate on non-advertising revenue streams. As well as charging fees for access to the search engine, the company also started charging for a range of other services, such as on auction listings. Yahoo! also changed their approach to advertising by building relationships with traditional advertisers that focused on more traditional forms of advertising such as linking portal users to the products they use and offering rewards for feedback or information given. The Corporate Yahoo! initiative underpinned the relationships the company sought with global companies such as Pepsi, McDonald's and Quaker Oats.

Despite all the changes that Yahoo! put in place to restructure and re-energise the company, the financial sector remained unimpressed. Most analysts and investors believed that only a major partnership or merger with another media giant could drag Yahoo! out of its malaise. Several companies were touted as potential suitors for Yahoo!, including Disney, Viacom and Vivendi Universal. However, the management at Yahoo!, and David Yang in particular, steadfastly resisted the merger option.

By 2001 it had become painfully clear that the presence of Koogle and Yang, alongside Chief Operating Officer Jeff Mallett, had become as much a liability as a driving force for Yahoo!. Confidence in their ability to take the company forward had diminished where it mattered most – in the hearts and minds of financiers and investors. Several major management changes followed including resignations from key posts in international markets, such as Savio Chow in China and Mark Rubinstein in Canada. The most significant, however, was when Tim Koogle vacated the CEO position to become vice-chairman of the company in March 2001. By April, a new era at Yahoo! began with the appointment of former Warner Brothers co-chairman Terry Semel as CEO.

The new regime at Yahoo!

When Terry Semel took over as CEO at Yahoo! the first thing that he realised was that the company did not operate much differently from when it first trailblazed its way into the consciousness of net users in the mid 1990s. The company still relied on the power of the brand and the loyalty of users that the brand bought. The management structure was still very centralised just as it had been from the company's inception. Although the number of business units had increased, all budgetary decisions were made by only a few people at the apex of the organisation.

One of the first moves Semel made was to reduce the number of business units to make the firm more manageable, flexible and focused. It also served to reduce costs. He also set about surrounding himself with managers he knew and trusted. Two important approaches to achieving growth were identified. Firstly, to make the existing businesses work better and generate improved revenues, and, secondly, to expand services into new markets where first-mover advantages were still up for grabs. Managers were appointed to oversee the mergers, acquisitions and partnerships that would facilitate these growth strategies.

In many ways the new regime breathed new life into Yahoo! by reinventing the organisation along a clearly defined pathway that featured broad-based media services at its core. Semel ensured that his Hollywood contacts would serve Yahoo! well by tying up deals with a wide range of firms in the creative industries. There was also a move into the music industry with the acquisition of Launch Media, a producer of CD-ROM music magazines and web-based streaming music and video content. Other big deals followed including a lucrative tie-in with Sony where mutual promotional benefits were derived. Importantly, the deals with Sony, Disney and other big media players gave Yahoo! the credibility to pitch for the position of online marketing partner of choice for the giants that ran Hollywood.

The Semel era at Yahoo! heralded some significant changes but the centralised nature of management remained. This was deemed necessary to push through deals quickly. The high number of new initiatives and the rollout of new services required a great deal of speed and flexibility and it was determined early on that this could only be achieved by a streamlined management structure.

Despite the frenzied activity in expanding markets and services, investors remained sceptical. Between 2000 and 2003 the market capitalisation of Yahoo! had declined from \$130 billion to just over \$5 billion. To turnaround the company's fortunes both metaphorically and literally, Semel undertook to reinvigorate the company not just in the USA, but across the globe. Key markets were identified and resources poured into making them work.

Yahoo! in Europe

Since 2000 Yahoo! has increased operations around the globe, most notably in Europe and the Far East. However, it is only in the USA that the company has reached a critical mass of customers. The European market is seen as crucial to the growth of Yahoo! and has been the focus of much investment by the company. To effect competitive advantage the company has operated a strategy of differentiation in local markets. The acquisition of key firms with specialist knowledge has been a feature of the marketing effort by the company in the European arena. In particular, the 2004 acquisition of e-shopping site Kelkoo for £319 million allowed Yahoo! to expand services into e-tailing and price comparisons. This is in line with the company's aim of expanding the range of services to customers.

Yahoo! Europe vice president Dominique Vidal believes that online customers have come through the learning phase of interacting with companies online and are now highly sophisticated in their choice of website and the value propositions. Competitive advantage is deemed to stem from continuous innovation and the supply of new products and services to customers. Consequently, Yahoo! has been engaged in broadening its portfolio of interactive services including video content, photographic services, music sharing and games consoles.

These services are designed to complement its core offerings of search, e-mail, short message services, news, weather, travel and financial information. To differentiate these offerings Yahoo! has focused on personalisation. This relates the service to the type of information each individual wants to receive, what games they want to play, what music they want to hear and the main search sites they habitually want to access. For example, the firm has a service called Y360 that builds on the personalised MyYahoo! home page. To achieve the aim of personalising services the company has acquired a number of specialist firms in each of the service provision areas. Acquisitions include Flickr (online photo storage), Musicmatch (music sharing) and Inktomi (search technology).

Europe is one of the key battlegrounds for internet heavyweights such as Yahoo!, Amazon.com, Google and e-Bay. All of these companies have expanded their products and services and now compete on what was previously deemed the preserve of one of them. For example, Amazon.com now competes directly with Yahoo! and Google by providing search facilities, e-mail and news services. Yahoo! offers an auction site that competes directly with e-Bay.

In Europe the challenge is to build market share and reach a critical mass of loyal customers. Another strategy for achieving this is to build partnerships with key industry players, especially telecommunications firms. In the USA Yahoo! has a partnership agreement with SBC. This arrangement allows Yahoo! to supply content for the co-branded internet service providers they share with SBC. A similar agreement exists with BT in the UK and others will follow in mainland Europe. All of these ventures in Europe are funded by the growth in advertising revenues, and the rollout of new services is likely to continue so long as that sector remains buoyant.

There is scope for even more growth in online advertising in the European market. In 2005 online advertising spend in Europe was between 1–4% compared to overall internet usage of 15%. Yahoo! intends to exploit the opportunities for gaining more advertising revenue as a means of financing their expansion plans in Europe.

Expansion into China

In 1999 Yahoo! entered the Chinese market trading under the domain name of cn.yahoo.com. The competitive environment in China presented some formidable challenges for the company as it sought to take advantage of the growing market for internet use in the country. These challenges included dealing with one of the most stringent regulatory regimes in the internet economy; the low volume advertising market in China; high market share of domestic internet providers such as Sina and Sohu; and the distinct cultural characteristics of the Chinese market. There were also concerns relating to where effective demand would stem from given that the domestic economy is characterised by low average incomes. Few people have credit cards in China, making payments slow and cumbersome. There are also infrastructure problems to overcome, especially in the area of distribution where delivery times lag significantly behind those seen in the West.

The main factor behind Yahoo! expanding into the Chinese market is the rate of growth of internet users in the country. Figures from the state sponsored China Internet Network Information Center (CNNIC) reveal that there were around 650 000 internet users in China in 1997 (CNNIC, 2003). By 2001 this figure had risen to 22.5 million. In 2005 the estimated number of internet users in the country reached over 100 million. If internet penetration of homes in China reflects growth rates similar to those seen in the West, by 2010 there will be a quarter of a billion internet users. The Chinese Government has recognised the economic potential of the internet and invested heavily in the restructuring of the country's telecommunications infrastructure to facilitate demand for internet services.

As well as the search facilities, Yahoo! offered e-mail, news services, instant messaging, and financial and weather information on the Chinese website. However, the response from Chinese consumers was one of indifference. The service provided by Yahoo! was the same as that provided in other local markets, except for the Chinese language provision. This generic strategy for service provision did not take account of the distinct characteristics of the Chinese market and made no attempt to gain knowledge of exactly what different types of services Chinese consumers wanted from a portal. Since 2001, Yahoo! has been engaged in market research with the aim of gaining a further understanding of the Chinese market and has enlisted the help of local managers to aid the learning process.

The regulatory regime under which Yahoo! had to build a market share also proved problematic. The Chinese Government has recognised the importance of the internet in driving forward the economy, but they have been wary of western companies who seek to influence the dissemination of information throughout the country. Companies such as Yahoo! are at the forefront of testing the boundaries of commercial freedom permitted by the Chinese Government.

In 2002, Yahoo! received criticism from human rights groups by signing a pledge called the 'Public Pledge on Self-discipline for the China Internet Industry' (Maldar, 2004). Although the main part of the pledge focused on promoting healthy competition in the internet industry there was also a clause that required companies to 'abstain from producing, posting or disseminating pernicious information that may jeopardize state security and disrupt social stability'. Whilst critics pointed to the restriction this placed on freedom of expression, managers at Yahoo! took the pragmatic view by accepting that there had to be a compromise on the differences between the business environment in western style democracies and the one that exists in China. The company also took the view that the pledge did not pose any restrictions beyond those already in place under Chinese law.

A more important reason for the initial failure of Yahoo! to penetrate the Chinese market was the reliance of the business model on advertising revenue. Demand for advertising on websites and portals was of such a low level in China that no effective strategy for growth could be built around it. The domestic portals in China had a better knowledge of the trading environment and built business models based around a series of services such as mobile phone ring tones, short message services and online games provision. Crucially, these services proved popular with the affluent and well-educated segment of the Chinese market.

Organisational restructuring at Yahoo! in the wake of the dot-com crash of 2000 also slowed the company's growth in China. One of the casualties was Savio Chow, managing director of Yahoo! Asia and the man responsible for the company's Chinese operations. After the bloodletting, Yahoo! decided to reinvigorate the Chinese operations and in 2003 set about adding to the services the company provided. The core activity of internet search was added to by introducing new functions such as Yellow Pages and geographical search facilities. The company also sought to steal a march on e-Bay by being the first foreign company to enter the growing online auction market.

In response, e-Bay acquired Eachnet, the Chinese auction site that had captured 80% of the market.

A series of acquisitions of key internet businesses in Hong Kong and the USA, alongside collaborations with Chinese firms, enabled Yahoo! to gain the capabilities and market insights to make an impression on the trading environment that was proving much more difficult to crack than anyone at the company had previously envisioned. An important breakthrough came in the form of Hong Kong-based internet firm 3721 Network Software that could provide search facilities using Chinese characters. Yahoo! acquired 3721 for $120 million in 2003 and the synergies provided a compelling proposition for Chinese customers. Yahoo! provided the brand and search technology and 3721 provided the expertise and understanding of the Chinese online market.

Other acquisitions of technology specialists, such as Inktomi and Overture, further enabled Yahoo! to develop its sophisticated search site. These investments ensured that Yahoo! went head-to-head with main rivals Google for market dominance in China among foreign providers. However, both Yahoo! and Google still faced formidable competition from domestic internet service providers.

The venture into the Chinese market has been a steep learning curve for Yahoo!. The company has had to rely on local expertise to gain an understanding of the distinct characteristics of the market. Through a series of acquisitions and partnerships Yahoo! has been able to combine its technical capabilities with the market expertise of others to provide a means of competing effectively in China. Nevertheless, the challenges that face Yahoo! remain strident. The company has to compete within the restrictions imposed by the Chinese Government whilst trying to make an impression against the brand loyalty that local firms had acquired through first-mover advantages. Meanwhile, other foreign companies such as AOL, Microsoft and Amazon.com have also made moves into the Chinese market, thereby further increasing competitive pressures.

Summary

Yahoo! is one of the most recognised brands in the world and certainly a leading force in the internet economy. The combined efforts of internet pioneers Jerry Yang and David Filo ensured that Yahoo! was a first-mover in the development of search facilities for internet users. The growth of Yahoo! from the mid to late 1990s was one of the most remarkable business phenomena of the late twentieth century. That the company survived the dot-com crash of 2000 was testimony to the resilience of the management team that had been assembled and the ability of the company to respond rapidly to changes in a dynamic business environment.

One of the key characteristics of Yahoo! has been the ability of management to continually seek improvement, develop and deliver new and innovative services, form partnerships, share knowledge and reinvent the organisation to take advantage of opportunities in the marketplace. These are the attributes of a modern, technology- and learning-based organisation seeking competitive advantage. Innovation has been at the heart of what Yahoo! is all about. The company has expanded services greatly and is now engaged in e-commerce, e-business, marketing, music and a host of other customer-centred activities. The evolution of Yahoo! has seen the business transformed from a dot-com providing search facilities to a truly global multimedia organisation.

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