
* * * * * **VStoreNews™** * * * * *

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IN THIS ISSUE:

Margin to Hell (For a Heavenly Cause)
Albertsons Launches Online Grocery Sales
Lands End Tests Internet Kiosks
Order Two Shirts, Get Egg Roll?
Macy*s Goes Virtual
BBBO Trades on Reputation
EToys Adds Membership, Registry
Online Shopping: Downloads From The Ether

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TENSER'S TIRADE:

Margin to Hell (For a Heavenly Cause)

VSN WORLD HEADQUARTERS, WESTPORT, CT — The impossible dream is coming true.

Just when you thought retail margin structures couldn't be shaved any lower, here come the heroic VStores. They have no bricks, no mortar, sometimes even no inventory to weigh them down, and they're selling the same old products for even less than the chains.

Consumers get lower prices. Conventional retailers gulp air and try to cinch their suppliers' belts down a notch. Manufacturers re-engineer their sales forces (again). And the rest of the players in the go-to-market system keep jockeying for position.

I'm telling you, it's like club stores déjà vu all over again. How long can these guys keep selling stuff for less than it costs? Remember 20 years ago when Sol Price, Jim Sinegal and the boys started selling those huge cereal boxes and cases of copier paper at unit prices that made the supermarkets and office supply houses pull their hair out? I knew a "famous brand" sunglass manufacturer who actually took to buying his merchandise back from the shelves at club store retail, just to keep his small optician customers from screaming bloody murder and boycotting his line (but that's another story).

It took a few years, but they spawned widespread industry reaction. Club packs started appearing on supermarket shelves (usually at loss-leader price points). EDLP champion Wal-Mart decided it had to have a leading position in the club business itself. Industry-wide initiatives were initiated, with impressive-sounding names written by committees, like "Efficient Consumer Response." Huge consulting windfalls were raked in by pundits clever enough to interpret the auguries and invent infernally complex solutions. Conferences were organized. New trade publications were launched.

Just like in any war. Some people get killed. Some get rich.

If you are reading this inaugural edition of *VStoreNews* — this newsletter being the first trade publication anywhere solely devoted to untangling the implications of the virtual store revolution — then I am betting that you're planning on being one of the rich ones this time around.

You've been following the impressive sales increases reported by online bookseller, Amazon.com. You've heard the radio ads from CDNow and read the articles about Macys.com. You've clicked on the Yahoo! and Excite shopping channels and explored the hundreds of links there from VStores offering everything from prime steaks to plastic flamingoes. You've bought shares of Dell Computer Corporation and watched them soar.

With some of the stock market's highest price-to-earnings ratios emanating from Internet commerce (witness Amazon and Yahoo!'s breathtaking multiples), now even the mainstream media are discovering Virtual Store Retailing. Why in the past week alone we saw front-page articles in *Time*, the *Wall Street Journal*, and the *New York Times* business section.

"Kiss Your Mall Goodbye," declared the *Time* cover line, "Online shopping is faster, cheaper and better." (That rumble you hear is the sound of thousands of brick and mortar retailers' hearts pounding in unison.)

The *Times* insisted, "Virtual Stores Give the Big Retailers A Foothold Against On-Line Upstarts," as it documented the feverish competition now brewing in the toy category. Now even Toys "R" Us, which was slow getting out of the box, has got VStore functionality on its Web site. Christmas shopping will never be the same (thank goodness).

But the *Journal* writer George Anders really nailed the situation with his "Cybersqueeze" analogy: "The very things that attract us to the Internet — speed, convenience, and unlimited breadth — make it treacherous for profit-hungry merchants. With just a few keystrokes, consumers can play business rivals against each other. That ability in turning the Net into a relentlessly efficient market in which vendors will be hard-pressed to win, and defend, any lasting competitive advantage."

Wow. He's almost got the whole picture there. Just one more logical step and he would have distilled the huge impact Internet retailing is about to have on all retailing. Gross margins as we know them are all in jeopardy. Not just for VStores, but for every competing retailer, regardless of format.

Like the club stores before them, virtual stores represent the trigger for a whole new margin structure for consumer products retailing. Like club stores were two decades ago, VStores are the Next Channel. They will bleed away a fraction of the conventional retailers business in the next couple of years — maybe 3% maybe 5% — and that \$70 billion will be enough to change everything.

Find that analysis to be a stretch? Well consider its three key corollaries:

- 1) *The biggest VStore opportunities lie not with the highest-priced or highest-margin products, but with the most frequently-purchased products.* Most households will spend more on consumable products like groceries year in and year out than they will in any other consumer category. Buying groceries could be the "killer app" that will bring online shopping to the masses.
- 2) *Only a few percent of consumer spending has to shift from "brick & mortar" stores to virtual shopping for a major economic displacement to ensue.* That's because so many stores are surviving on the brink already that to sustain a loss of a small percentage of their best customers could put them out of business.
- 3) *Product marketers will have to adjust their go-to-market systems, pricing, sales contracts, deal terms, promotional strategies, sales organizations and packaging, to contend with these emerging realities.*

When the underlying economics change, the rules have to change too.

Now, there are a lot of folks out there wondering if any retailers are going to get rich in a world populated by VStores. After all, Amazon.com isn't showing any profits. Neither is Peapod. Is making money selling consumer products on the Internet an impossible dream? Will "relentlessly efficient" consumer pricing simply drive all profitability out of the consumer value chain?

I'm prepared to offer a bold prediction, based on history and speculation: VStores will rise, causing gross margins to drop. New efficiencies will be developed that will radically redefine the value chain for consumer goods. Some retail companies will be casualties of war. But some others will find the right formula of marketing, sales, transaction and fulfillment to make it work. They and their investors will get rich, and consumers will get even better prices and services.

My Advice?

Expect everything to change, and faster than you would believe.

JAMES TENSER, Editor & Publisher

Albertsons Launches Online Grocery Sales

BOISE, Id. — Albertson's here, a major force in the supermarket industry, stepped boldly into the virtual store business this month, when it launched an online grocery sales pilot in parts of the Dallas-Ft. Worth market.

Ads touting the new service began running in area newspapers during the first week in July. Called, @lbertsons.com (www.albertsons.com), the VStore employs a sophisticated shopping cart engine, which allows customers to search out products by sortable category, or opt for a solutions-based concept called "Shop & Discover."

The company was typically tight-lipped about its venture, declining to grant interview requests. It posted no press releases about the new activity on its corporate Web pages. However, the company did run several newspaper ads in the *Dallas Morning News* during July. And people in the market are talking about it.

Albertson's is by no means a pioneer in this activity. Competing regional grocery powerhouse Tom Thumb has been offering on-line groceries here for more than a year, in one of several regional alliances now operated by Peapod Inc., Skokie, Ill. The local Kroger division had also offered Internet shopping and delivery through OnCart for a number of months, until OnCart's business collapsed last March.

Sources said Albertsons had negotiated in earnest to buy Peapod several months ago, but that the 950-store Albertson's chain found too many incompatibilities with its own business. The talks were handled concurrently with the @lbertsons.com development, which stretched back nearly two years.

The Albertsons VStore is set up as a separate division, so as not to interfere with the operations of local stores. The company built a dedicated fulfillment facility in the Dallas-Ft. Worth area where online orders are received, picked and prepared for delivery.

The Web interface appears to be proprietary as well and it incorporates several nifty features beyond a smooth-functioning virtual shopping cart and secure credit card payment capability. Most notable is a live chat function that links directly to a customer service representative. In an impromptu test of that function, well-informed representative appeared in a chat window within one minute after a query was posted.

@lbertsons.com is described as a pilot program by people close to the company. It has enjoyed the benefit of some six months of quiet local testing, working with several local companies to provide Internet grocery shopping as an employee benefit. Dallas-based Frito-Lay, for example, allows its corporate employees to shop over the Net during lunch hours or breaks. @lbertsons.com delivers to their office buildings or homes.

Albertsons is seeking to market this benefit through with large area employers as well.

Lands End Tests Internet Kiosks

DODGEVILLE, Wisc. — Just what is a virtual store anyway? Lands End, the \$1.3 billion annual sales sportswear cataloger based here, is stretching the definition.

The company has begun pilot testing Internet-based kiosks located in the Traveler's Inlet, a retail location within the Minneapolis-St. Paul airport in Minnesota. The free-standing units are described as dedicated touch-screen terminals which connect back to the company's highly-functional VStore.

A total of five Lands End kiosks are currently in operation there, three inside the store itself, and two more which stand outside in the corridor, allowing 24-hour access.

Willie Doyle, manager, advertising & electronic media for the sportswear seller, disclosed only a few details about his company's test during a Q&A session at the recent Retail.Net in Chicago, a conference

sponsored by the Institute for International Research, New York. "They are working great," he responded to a questioner.

For Lands End, which has already amassed eight years of experience selling on-line and fulfilling catalog orders received by phone, fax and online, the addition of public kiosks would seem like just another way for consumers to get information and make their orders. The back-end — delivery and financial — needn't change a bit. In the end, Doyle agreed, it doesn't matter how the consumer gets that information or communicates so long as Lands End records the sale.

"Our goal is to turn the computer into what the phone is," he said. "a transparent communications tool."

The web site, www.landsend.com, launched in June, 1995, after some years of experience with early online services such as Prodigy and GEnie. The company's order-taking and fulfillment processes are among the best in the direct sales business.

Order Two Shirts, Get Egg Roll?

NEW YORK — For Manhattan dwellers, delivery and take out are practically a way of life. Call the Chinese place around the corner and hot food is at your apartment door within half an hour.

So it wasn't much of a stretch for this urban crowd to adapt to the concept of ordering sportswear basics for 1 to 2 hour delivery. When Gap Inc. began offering this option earlier this summer, they took to it like, well, like egg rolls from Shun Lee Palace.

The San Francisco-based clothing retailer inaugurated its Gap To Go service on June 15, with a multi-page advertisement in New York magazine, which included a tear-out fax order form. The ads promised same-afternoon delivery from what it described as a "focused" assortment of its most popular clothing styles — about 21 items for men and women, each in a variety of sizes and colors.

"Response has been great," said Rebecca Weill, Gap spokesperson. "New Yorkers are embracing the concept. They love to have things delivered and fast."

A specialized local service, Gap to Go is only loosely connected with the 8-month-old Gap Online (www.gap.com), a national VStore which fulfills orders using common carriers like UPS and Fedex and USPS. That site debuted in Nov. 1997 (about 8 months so far). Gap.com uses Microsoft's Site Server, virtual store engine and it fulfills orders through Gap's distribution center in Erlanger, KY.

Weill said Gap To Go customers may view information and download the fax order form from the web site but as of this writing they cannot place a delivery order directly on line.

Orders placed between 7:00 am and 7:00 pm Monday through Friday are promised for delivery within one hour for a \$13.00 delivery charge. Two-hour timing cuts the cost to \$10.00. Orders placed at night are delivered the next day, with pre-8:00 am delivery available.

Fulfillment and delivery are handled from either of two Gap stores: one in Midtown Manhattan at 34th Street and a second in the tony beach resort town of Bridgehampton, in eastern Long Island. All of which plays right into the instant gratification lifestyle of mobile young New Yorkers, who may commute to area beach resorts on a couple hours notice.

Macy*s Goes Virtual

CINCINNATI — Federated Department Stores Inc. here has created a freestanding subsidiary to operate Macys.com (www.macys.com) its first effort at online retailing. When site is re-launched in October, and Federated said it will be the first full-line department store to establish a subsidiary devoted to Internet sales. In doing so, the company said, it is betting on significant sales expansion for department store type goods online over the next few years.

The Macys.com web site has been operated since early 1996 by the Macy's West division of Federated in San Francisco. Until last month, it was primarily an information site, with some experimental online selling. Kent Anderson, a Macy's West executive who had been overseeing the online activity was named president of the new division.

Anderson said the new Macys.Com site will focus on creating a “true cyber-shopping experience for the customer.” More than 250,000 SKUs will be available for purchase “in a cyber environment that mirrors the department store in merchandise presentations and product offerings.”

Additionally, Macys.Com will offer its online customers the ability to make merchandise exchanges or returns at any of Macy's 188 department stores nationwide.

Macys.com said it is “negotiating” with IBM's Internet Division, which is expected to develop the e-commerce solution and host the site.

The current site already offers a limited selection of wardrobe basic merchandise, cosmetics, and bridal registry services, with secure online ordering. It employs the ShopHaven online shopping engine, from Computer Associates.

BBBO Trades On Reputation

ARLINGTON, Va. — Sharing personal information on a web site takes on a whole new dimension for consumers when the data provided includes a credit card number.

That's why the Better Business Bureau had Internet consumer research organization Greenfield Online, Westport, CT conduct an online survey about internet shopping habits in support of its BBBOOnline, (www.bbbonline.org) consumer Web site.

Results compiled from 500 Greenfield respondents, indicate two key concerns about virtual store shopping: security of payments and reliability of the businesses. To move most non-purchasers to begin Internet shopping, their fear about security of payments is the first factor that must be addressed.

In the BBBO survey, more than two thirds of respondents (69%) reported having placed an order online at any time in the past, with slightly more males (75%) than females (59%) reporting such experience.

Steve Cook, senior vice president, Greenfield Online, said 27% of the survey respondents who had shopped online said they were doing so about once a week. The majority (63%) said they shopped on line at least once per month. “We find that number astounding,” he said.

Of the 31% who said they had never made an online purchase, 75% were mainly concerned about the security of their payments. They also cited other barriers with less frequency, such as payment structure (46%), reliability of companies (36%), returning items (36%) and lack of privacy policy (33%).

On the other hand, survey respondents who had placed at least one order on line cited convenience as their main reason (88%).

Russ Bodoff, general manager of BBBOOnline, said the organization had established its Internet site a little over a year ago so that member businesses could provide online shoppers with clear proof of their legitimacy and eliminate the fear of making that first transaction online.

The site now has more than 1,200 businesses in its search engine. Consumers can search for member companies that carry the BBBOOnline seal. Or they can click on the seal when found on a member company's site to confirm its membership in the association.

“Our feeling is that fear of credit card abuse is probably overblown,” said Bodoff. “The Internet is probably the safest place to use your credit card, particularly where the site has a secure server.”

eToys Adds Membership, Registry

SANTA MONICA, Ca. — Up and coming virtual toy store operator eToys.com is launching two new consumer loyalty programs — one this month and another by summer's end.

The Vstore operator has just launched a membership program for online shoppers that it calls “my eToys account.” It offers registered consumers access to additional services including a birthday reminder service, a personal address book and promotional offers. The program is already active on the eToys Web site, which currently offers 3,000 toy SKUs from 290 manufacturers.

An additional online gift registry service is anticipated for launch by the end of this summer, said Phil Polishook, vice president marketing for eToys here (www.etoys.com). He discussed eToys' progress to

date at the Retail.Net conference in Chicago, sponsored by the Institute for International Research, New York.

“This membership program is an attempt to counteract the natural tendency of the toy business to be heavily concentrated in the two weeks prior to the Christmas season,” said Polishook, who noted that so far, 60% of eToys sales have been holiday related. Not surprising, since the site launched on Oct 1, 1997.

Coming by late summer will be a gift registry, which enterprising pre-adolescents might use to post their birthday wish lists for access by grandparents and other doting relatives.

The goal of locking up customer relationships probably holds some urgency for eToys, which is backed by several venture capital organizations, including Idealab, Pasadena, Ca. There are some heavy hitters in the toy business coming on stream. Most notable are new entries from Toys ‘R’ Us (www.toysrus.com) arguably the most powerful buying organization in the toy industry, and Noodle Kidoodle (www.noodlekidoodle.com), the educational toy chain.

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ONLINE SHOPPING:

Downloads From The Ether

Two Key Food supermarkets in Queens, N.Y. began testing an Internet home-shopping program in March. Called HomeDelivery.com (www.homedelivery.com), the new service offers a range of more than 8,000 items across grocery, non-food, perishable, and services categories. The two Key Food stores are operated by Gemstone Supermarkets, based here. Shoppers may access the HomeDelivery site through a link at the retailers Web site, www.keyfood.com. David Mandell, principal of Gemstone, said it has been delivering a few dozen orders per week to shoppers throughout New York City and neighboring Nassau County.

HomeDelivery.com is a diversified Internet shopping service, operated by ADF Ventures, Inc., a company controlled by local entrepreneur Ari Freedman. In addition to a well-designed shopping cart system for groceries, the site offers access to some 200 local shops and catalogers, which are served up according to the shopper's zip code. While HomeDelivery.com is currently serving the Metro New York market only, plans are to expand the service nationally by fourth quarter of this year.

Ingram Entertainment, LaVergne, Tenn., the nation's largest distributor of recorded entertainment, and the supplier to many supermarket video programs, was revealed last month to be the owner of Speed Serve, Inc., a World Wide Web site which permits it to offer video tapes, books and games on line. The disclosure, confirmed by Ingram chairman David Ingram, appeared in *Supermarket News* in June.

Accessed at www.speedserve.com, the site offers three main services: VideoServe.com, BookServe.com, and GameServe.com — the names are self-explanatory. Of greatest competitive concern to grocers is the video offering, with carries 85,000 movies, 700 DVD titles and 1,900 laser discs at discounts of up to 25%. Links on the site invite current brick and mortar retailers to form alliances by linking in their web sites. Obviously, the video rental business is not threatened by this newcomer.

Created by Michael and David Mason, sons of David Mason, a longtime executive of Ingram, VideoServe appears set on moving sell-through video to a worldwide market. Its pages include shipping information for the U.S., Canada, Germany, Sweden, the U.K., Puerto Rico and Guam, as well as military installations world wide. The site carries an IBM e-Business logo.

Internet “Portal” Operator Yahoo said it would spend \$49 million in stock to acquire Viaweb, a company that sells software and Internet commerce services to small businesses. Plans are to immediately rename the service, “Yahoo Store.” The core service provided is web hosting for small VStore operators, at prices starting as low as \$100 per month, and up, depending upon the breadth of the product offerings.

America On Line and NetGrocer have concluded a deal under which NetGrocer (<http://www.netgrocer.com>) will pay AOL \$15 million or more for the exclusive online supermarket

delivery service for the next three years on AOL and for the next two years on its Web site, www.aol.com. AOL, based in Dulles, V A, will also share in advertising and transaction revenue once certain thresholds are met, and will receive warrants to purchase shares of NetGrocer.

NetGrocer, based in New York, sells non-perishable supermarket items over the Internet. The AOL deal gives it access to the online giant's 11 million members in the United States, in addition to people who visit its Web site.

Separately, NetGrocer announced last month that it had revamped its Web site to work faster and more smoothly, result of improved site navigation and product displays. This allows the product selection to be broadened by "several thousand items." The site has also been made searchable, and its saved shopping cart function improved. A quick step through the shopping process confirms progress has been made here.

Drugstore.com is the domain name reserved by the developers of a long-rumored virtual drugstore. Jed Smith, a former executive at Oracle, registered the domain, as well as Adrugstore.com, with the InterNIC registration service, but neither link was active by press time. The acronym KPCB follows his name in the listing, which reportedly stands for Kleiner Perkins Caufield & Byers, a venture capital firm based in Menlo Park, Ca. Peter Neupert, who recently resigned a senior post at Microsoft, is also associated with the venture, according to *The Industry Standard*, a Silicon Valley trade magazine, which also reported an unspecified relationship between Drugstore.com and Amazon.com. This one bears watching.

Famed divorcee Ivana Trump is teaming up with Tel-Com Wireless Cable TV Corp., Miami, to launch a combined video and .Internet venture this fall. Called the 5th A venue Channel, the new venture will "cater to the interests of the affluent and influential," according to a preview message on the website, www.5thavenuechannel.com. Content for the television channel and virtual store will be highly integrated, and will include business news from Bloomberg, and tie-ins with several magazines, including, *The New Yorker*, *Architectural Digest*, *Vogue*, *Vanity Fair*, *GQ*, *Town & Country*, *Gourmet*, *The Robb Report*, and *Forbes*. The Web site will be designed as an extension of the channel itself, and will serve as an on-line store as well as a home page for a membership group, the 5Th Avenue Club. Trump will of course, take a high-profile role in promoting her own lines of luxury products and services.

OnCart, the defunct Internet grocer, which shuttered its web site in March, has not quite faded out of existence. As a click on its link (www.oncart.com) reveals, some kind of thirteenth hour talks appear to be going on with Peapod, its former rival. The message on its page says, "We are currently unable to take any orders. We sincerely apologize for any inconvenience. Interested in online grocery shopping? Check out Peapod, the #1 Internet Grocery and Drug Store." A hot link to Peapod is included. What's up with that? Till Dorgan, executive vice president of Peapod would only say that it was an effort not to leave OnCart customers out in the cold. But Peapod is currently in no position to make deliveries in most of the markets where OnCart had done business. We'll keep an eye on this one.

For its part, Peapod (www.peapod.com), Skokie, Ill., announced a plan in late July to add metropolitan New York to its roster of served markets beginning in the fourth Quarter of 1998. The hot news here is that it also entered in to a multi-chain deal with Ahold USA (www.aholdusa.com), the Atlanta-based arm of the Dutch supermarket giant Royal Ahold. Peapod signed a deal with Ahold divisions Edward's Food Stores and Giant Food Stores, Inc., under which the brick and mortar grocers will provide warehousing and buying services and share in the marketing of the new venture. Peapod will initially service households on Long Island, using a dedicated fulfillment facility for order picking and delivery. New Jersey, with its own dedicated facility, will follow in early 1999, with New York City, Westchester and Connecticut to follow. Toss in the option to expand into Philadelphia, Maryland and D.C., and the Peapod/ Ahold deal could turn up big.

Branding has reared its whiskered head in the online computer marketplace of late First Dell Computer Corporation (www.dell.com) began promoting its brand image in a \$70 million series of magazine and television ads with the tagline, "Be Direct." The odds-on favorite for ridicule was the TV ad from early

June that featured an enterprising rat faced with a wooden maze. "What's the best way to deal with obstacles?" asks an announcer as the rodent strikes a match. "Eliminate 'em!" Once his quest for cheese has been disintermediated (that is, reduced to ashes) the furry fellow smirks at the camera. This apparently is ad agency J. Walter Thompson's idea of image advertising. The print ads, which share the "Be Direct" tagline, were mercifully, rodent-free.

Not to be outdone at the branding game, CDW Computer Centers, Inc. (www.cdw.com), a computer products vendor based in Vernon, Ill., said it would begin a branding campaign of its own. It has committed \$85 million through 1999, which would be spent on various media activities to be specified soon. The goal, the company said, was to break out of the direct-response rut and build a name with consumers outside its core constituency of computer enthusiasts.

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