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IN THIS ISSUE:

TENSER'S TIRADE:

Embrace Complexity, Stupid!

VSN WORLD HEADQUARTERS, WESTPORT, CT — Cybernetics is a term coined by mathematician Norbert Wiener for the study of control processes in electronic, mechanical and biological systems.

Wiener wrote brilliantly of this subject in his books **Cybernetics** (1948) and **The Human Use of Human Beings** (1950), and thereby created the underlying disciplines that led others to create digital computing and communications technologies. You might say that cybernetics begat cybershopping.

Cybernetic theory teaches us many things about what makes communications effective. I find particularly useful those principles which relate to improving the odds that a message is received and correctly understood. They apply equally well in device-to-device communications and in human-to-human communications. I would argue that they are central to retail success, virtual or terrestrial.

How do you get your message through better? Well for one, you can *turn up the power*. Up the signal strength. Shout. You can also *reduce the noise*. Filter out static. Take your conversation partner into a quiet room.

You can *repeat the message*. Hit the "re-send" key. Build redundant channels. State your ideas over and over until you are blue in the face.

You can provide a *mechanism for feedback*. This is the key difference between interactive, two-way media and passive, broadcast media. Listen to what you partner (or customer) says in response to your words or actions. Look them in the eye for a glimmer of understanding.

You can *add more bandwidth*. A bigger information pipe allows a more data to be sent. The richer the message, the better it may be understood. A telephone call is easier for most people to comprehend than a telegraph. If you gesture expressively while you talk, your partner is more likely to understand the meaning behind your words.

All of these techniques add complexity to the message or the messaging process in order to improve communications. A worthwhile tradeoff, I'd say. It's why we put talk-back links on our Web sites. It's why many of us dream of a wide-band Internet that will carry rich interactive shopping experiences into people's homes.

It's also why it makes sense that many existing retail chains are adding cyber-storefronts — they provide another way to interact with consumers on their terms: More bandwidth means an additional channel of communications with shoppers. More volume, less noise means a more intense, exclusive shopping experience for those consumers who choose to use this channel. More mechanism for feedback — well the interactivity of the Internet is ideal for this.

Interestingly, the term "cyber," as in cyberspace, cybersex and cybershop, is derived from a shortening of Wiener's terminology. He in turn derived it from the Greek *kybernetes*, which means "steersman" or controller. So cyber indirectly refers to control.

Ironic, eh? To this observer, the World Wide Web seems anything *but* controlled. It's a writhing, seething communications organism, with few rules or limitations. No wonder bricks-and-mortar retailers were initially skittish about online selling. It seemed too complex. Too uncontrolled.

That's changing fast. As Ernst & Young (www.ey.com) reported last month in *its Second Annual Internet Shopping Study*, 39% of surveyed retailers began offering online shopping during 1998. Another 37% have plans to do so — two thirds of them during 1999. (*Read more below*.)

These findings indicate that major retailers now understand how imperative it is that they embrace the complexity that goes along with operating a virtual storefront. They recognize how adding an online presence broadens the bandwidth of their shopper interaction. They accept the systems, logistical and supplier relations challenges that this implies. They are determined to compete effectively with the new breed of pure online retailers, by leveraging their brand equity, capital depth, and merchandising know-how to press their advantage.

As for the oft-cited K.I.S.S. principle: "Keep It Simple, Stupid" comes off as too simple and too stupid in the context of the Vstore reality.

Wiener's work suggests that when it comes to effective communications and control, simplicity is not the answer. Reflexive opposition of complexity may in fact be the more perilous course.

My Advice?

Kiss off the K.I.S.S. principle. Bandwidth has value. Purposeful complexity can pay off.

***JAMES TENSER*, Editor & Publisher**

. . . . **TRULY QUOTED; DULY NOTED** . . . .

"Everything should be made as simple as possible, but not simpler."
— Albert Einstein

NRF EXPO:

Chain Store Industry Builds E-commerce Buzz

NEW YORK — They don't necessarily know what to do about it, but they know it's important.

Participants in last month's National Retail Federation Expo at Manhattan's Javits Convention Center were all abuzz over the astounding online sales growth results posted by Vstores this past holiday season.

Like a magic word, "E-commerce" was invoked early and often by presenters at the three-day event, and the aisle chatter was peppered with anecdotes about the experience of the heady prior weeks.

"Wall Street is asking every retailer, 'What is their e-business strategy?' and they feel compelled to say they have a presence," said Rob Hafker, managing principal — retail industry, for IBM's Consulting Group (http://www.ibm.com/services/consulting) , in a presentation.

"In the last 30 days, virtually every retailer I talk to says his number one priority is to do e-business," he added.

William Fields, president & CEO of the Hudson's Bay Company (www.hbc.com), told a General Session audience he considered the Internet to be "the most efficient catalog that can ever be produced," and added, "Really, that is the future of marketing."

A co-panelist with Fields, R. Brad Martin, chairman and CEO of Saks Incorporated (http://www.saksincorporated.com), also took a positivist view of the Vstore revolution: "I see it as a business process improvement opportunity."

Introducing a breakout session on "Consumer Direct," Jannita Watson, a principal at consulting firm Kurt Salmon Associates (and a true master of understatement), warned the packed house, "The gradual increase is over. We are heading into an era of rapid growth." (http://kurtsalmon.com)

Many "pure play" Vstore operators are pressing pedal to the metal in a headlong effort to acquire market share. The profits will have to wait, goes the insiders' wisdom, right now the name of the game is finding customers first.

Rod Parker, senior vice president of online music retailer CDNow (http://www.cdnow.com), summed up this mentality succinctly in response to an audience question. "The time for profits will be late 2000 or 2001. We have told this to the analysts. Our repeat customer sales have been enormous. We feel we have been very successful."

Analyst Concurs

Wall Street apparently accepts this assessment.

"Ultimately, you need to be profitable to be a success online," said David Bolotsky, VP Goldman, Sachs, Inc. (http://www.gs.com) in another General Session. "But there's a land grab going on right now, and you may have to make an uneconomical investment today to own the market later on."

Bolotsky pointed out that with 20% sequential growth, quarter after quarter, Wall Street is still enamoured with the Internet and speculated that if Amazon.com raised their prices by 5 or 10 percent, sales might not fall.

"As a retailer, you need to play to win or don't play at all," Bolotsky offered. "If you're a dominant mall operator and you're thinking of opening free-standing superstores, you only do that if you're going to be the best. The same holds true for the Internet."

Bolotsky again speculated than many retailers might turn to Wall Street for more capital. "You're going to see retailers say we don't want to play with one arm tied behind our backs with the Internet upstarts. Let's slice off our Internet business and take that public so we can fight with the Internet retailers on a level playing field."

"Retail brand names don't equal success online," declared Jeff Tauber, Chairman and CEO of CyberShop, Jersey City, NJ in a "myth shattering" presentation. CyberShop owns and operates www.electronics.net, www.egift.com, and www.cybershop.com, a virtual department store that sells name brand items.

"Building a retail store on the web is costly, and it's important to be the first mover in a category," Tauber said. "And don't expect to use your existing customer service and logistics assets for your online store. You may need a separate warehouse, inventory, and customer service department. And just because your store has large assets, don't expect profitability to lurking around the corner. Selling online is not easy, and you might not see a profit for years, so be prepared to spend money."

Long term portal deals are not necessarily a key to success, either, said Tauber. "Online retailers should always keep their return-on-investment in sight."

Tauber predicted that many online shoppers are coming from catalog shoppers and that online will rapidly overtake mail order retailing. "Don't be fooled in thinking mainstream America is not connected," Tauber said. "They will be." **— JUDY CORCORAN CONTRIBUTED TO THIS REPORT.**

INTERNET SHOPPING 1999:

E&Y Report Shows Meld of 'Bits and Mortar'

NEW YORK —The big guns of chain retailing are barreling into the virtual store marketspace with a take-no-prisoners resolve.

More than two thirds of current "brick and mortar" retailers have firm plans to be merchandising their wares in "bit" form by the close of 1999, said Stephanie Schurn, VP Marketing, Ernst & Young, in her opening remarks at the National Retail Federation Conference here last month.

"The proportion of retailers selling online to consumers more than tripled from 1997, from 12% to 39%, while the number planning to sell online jumped from 22% to 37%," according to the Ernst & Young Second Annual Internet Shopping Study, which Schurn unveiled at NRF. The combined percentage of those who are selling or are planning to sell online goes from 34% to 76% in the study.

Online revenues are projected to grow from 3% of total consumer retail sales in 1999 to 9% in 2001. Currently 46% of retailers' online stores report profitability and that number is expected to reach 92% within the next two years. (More information about the study may be obtained from the Ernst & Young Web site, http://www.ey.com.)

On the whole, Ernst & Young found online shoppers to be better educated and wealthier than the population overall, but their leisure-time pursuits are not much different than the average household. While 68% of online shoppers are age 40+, 75% of the population fall into that age group.

Schurn observed, "There is no one profile of online shoppers."

The majority of manufacturers (57%) responding to the study said they don't and won't sell online to consumers. But 15% reported some online sales, up from 9% last year, and the number that plan to sell online (28%) more than doubled from last year's 12%.

Another encouraging trend is that consumers are spending larger amounts of money on the web. According to Ernst & Young, 26% of consumers who bought online spent more than $300 in 1997. One year later, that number increased to 35% with 19% spending over $500.

What Consumers Are Buying Online

1. Computer-related products	49%
2. Books	35%
3. Consumer electronics	34%
4. Travel Reservations	28%
5. Cars, boats	19%
6. Clothing and apparel	18%
… Recorded music, CDs	18%
8. Larger household goods (furniture, major appliances)	15%
9. Filmed entertainment, videos	13%
10. Gifts delivered by mail (flowers, candy)	12%
11. Publication subscriptions	8%
… Investment or financial services	8%
… Food and drink	8%
14. Artwork, poster, etc	4%
15. Other	13%

Source: Ernst & Young Internet Shopping Study 1998

Top Concerns Of Retailers And Manufacturers

The Ernst & Young study stated the top three concerns of both retailers and manufacturers to selling online. Retailers cited these reasons: (1) Conflict with investment in physical stores; (2) Technology issues; and (3) Lack of distribution and fulfillment network.

Manufacturers stated that infrastructure was less of a concern. They mentioned: (1) Products not appropriate for online sales; (2) Potential risk to channel relationships; and (3) Consumers won't buy online. — **JUDY CORCORAN**

NRF EXPO:

Who's Got The Virtual Edge? Why, The Brands, Of Course

NEW YORK — Representatives from Macys.com, Goldman, Sachs, Inc., Dell Computer, and Nordstrom met on a panel at the National Retail Federation Conference in late January in New York City to discuss making money on the web.

Kent Anderson, President, Macys.com (http://macys.com), said its online customer profile was looking more and more like that of Macy's store consumer. He identified three key drivers for the recent spate of online growth: gift-giving purchases, which skirted the consumers' need to touch the product; convenience items such as hosiery, cosmetics, garden equipment and specialty sizes; and technology improvements.

David Bolotsky, vice president and Internet commerce analyst at Goldman Sachs, Inc., pointed out that as more manufacturers support online sales, more categories will see growth. The consumer electronics category will be an example of this. But he pointed out the problem. “There are few compelling sites online. One of the reasons retailers are successful is that they have great stores and there still aren’t a lot of great stores online, although that’s changing quickly,” he said.

Richard Owen, Vice President, Dell Online Worldwide (http://www.dell.com) said, “Wherever you see highly defined products, you’ll see growth. At Dell, we’re not just selling computers, we’re selling the complete buying cycle, including delivery and service, online.” Dell, Owen reported, makes $10 million a day on the web, which translates into $350 per second.

Replenishment products in the apparel category were mentioned as a growth area. Bob Schwartz, General Manager, Internet, Nordstrom, Inc. (http://www.nordstrom.com), which is actively developing its brand online, said, too, that brands are playing a huge part in the web’s growth. “Look at Amazon.com,” he said. “In the web, the brand becomes the bridge of confidence between the consumer and the online experience.”

Online Sales Not Robbing From Stores

“We don’t see the web as a cannibalization of retail sales, we see it as growth without the capital investment of stores,” said Kent Anderson, President of Macys.com. “As a result of the Internet, Macy’s did business in 50 states last year — and 29 of those states don’t have Macy’s stores.”

The biggest concern at Nordstrom, said Bob Schwartz, General Manager, Internet, Nordstrom, Inc., is losing market share to others providing their type of service online. “It ultimately comes down to the consumer and whether the consumer wants to shop online or in the store — today,” he emphasized. “And unless you open online, you’ll be cannibalized or eaten by the competition.”

Richard Owen, Vice President, Dell Online Worldwide, said that it takes nearly $50 million to build a brand online. “We’re in a foot race, and it’s difficult for online retailers to exist and compete with companies that are not working in the same financial framework.”

The ever-present paranoia about disintermediation was evident but relatively subdued. Once session was entitled “Consumer Direct,” but it featured true online retailers as panelists. In general, participants evinced understanding that the strong retailers have an opportunity to create value by extending their brands through virtual storefronts.

Observed Goldman Sachs’ Bolotsky, “The Internet represents an opportunity for manufacturers to go direct to consumers and to bypass the retailer. My view is that most manufacturers will be reluctant to do that, and the best positioned companies are those that have their own brands. Companies like Crate & Barrel and Nordstrom, with few stores and tremendous customer awareness, could expand their market shares by moving aggressively online.” **— JUDY CORCORAN**

NRF EXPO:

Ten Ways Chains Can Leverage Retail Power Online

NEW YORK — During the NRF show, ***VStoreNews*** conducted some impromptu brainstorming in the Exhibit Hall, where we challenged various experts to propose techniques retailers can apply so as to leverage their investments in physical stores to complement their on-line presence.

Their responses, in essence, came down to a core principle: An effective virtual store can enhance an established retailer's standing with its customers by "widening the bandwidth" available for communications. Ideally, each consumer can then learn about the product using the channel he or she wishes, purchase the product using the channel he or she wishes, and obtain service for the product (including after-purchase service) using the channel he or she wishes.

The following list was provided by friends of ***VStoreNews*** that included: a CEO of an 80-person merchandise system consultancy; a COO of a specialty apparel retailer; a director of store systems software development at a mass retailer; and a VP of merchandising at an off-price apparel retailer:

10 Advantages of Adding Virtual Store Capabilities to A Retail Chain

1. Retailers can allow customers to return items sold over the Web at their stores.
2. Customers can buy on the Web, pick-up in store to save on shipping.
3. Retailers can use Web selling information to re-assort stores based on local customer knowledge gained through online interactions.
4. Customers can choose to browse online, review and purchase in store (good for high involvement items).
5. Retailers can register customers in store, sell to them on the Web. This has the advantage of a relatively low cost of acquisition of online customers..
6. The Web site is a good, inexpensive way to send alerts about in-store selling or entertainment events.
7. Deploy Web site to in-store kiosk to address shadow demand or extend inventory.
8. Customers can buy in the store, track progress on web (good for custom-built product segments like upholstered furniture, tailored clothing).
9. Use the Web site as a traffic driver, buy promoting products for sale in the stores.
10. Consumers can review or consider purchases in stores, buy at home (good for items seen in show rooms, like cars or audio equipment or items seen on vacations).

Source: VStoreNews 1999

(Editors note: The issue of returns has received a great deal of attention since the show. It is important to remember that return rates for various merchandise categories, such as apparel — a category that has traditionally seen return rates that are higher than books and music. See the Direct Marketing Association to learn more about catalog return rates). — **VAHE KATROS**

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DOWNLOADS FROM THE ETHER :

Caveats from Toyland; Drug Overload; Health Foods

One of the bright spots from the holiday season recently passed was the emergence of a little online toy seller named eToys (http://www.etoys.com) into the bright glare of monitor lights across the country. On the strength of some 3.85 million visitors and $22.9 million in sales in the fourth quarter of last year, eToys appears to be well on its way to greatness in the children's products sector. Even its entrenched rival, Toys 'R' Us (http://toysrus.com), couldn't match eToys' online prowess (just 1.17 million visitors).

So it comes as no great surprise to learn that eToys Inc. is ready to take its robust business story to public investors. The company announced its initial public offering this month. VSN got hold of the preliminary IPO document and we note with some irony that the book features a lucky 13 pages of "Risk Factors." Everyone of the caveats is sober and appropriately stated. None appear damning to eToys based on our quick perusal. But the fact is that even a leading player in the Vstore sector must point out the many ways that their business might fall short of its promise. This is a very new business channel, but in the stock market, as in the virtual store, let the buyer beware.

A new drug for giddy investors? With the long-awaited launch of Drugstore.com comes a surge of mainstream media coverage for the online health, beauty and wellness sector. Suddenly, on the strength of the startup's cast of marquee players (especially President and CEO Peter Neupert, ex- of Microsoft) and high profile investors (Kleiner Perkins Caufield and Byers, Maveron, L.L.C. and Liberty Media) the real world is taking notice.

On January 11, the Redmond, WA-based Vstore announced that Howard Schultz, Chairman and CEO of Starbucks Corp. would take an equity share in the new e-commerce site through Schultz's private investment company, Maveron, L.L.C. As an equity shareholder, Schultz will also serve on drugstore.com's Board of Directors. Financial terms were not disclosed.

Within weeks, the company announced so-called "distribution" deals with AOL.com and Excite.com. Then most remarkable of all was the announcement, concurrently with the Vstore's debut on Feb. 24, that Amazon.com would acquire a 48% interest in the company and a seat on its board.

Putting aside what that suggests about Amazon's strategy of retail domination, the rush to deal with drugstore.com is testimony to the deal-making prowess of its key players and backers. And also a feather in the cap of its public relations counsel.

But it's worth noting that drugstore.com is not entering an empty field, like Amazon.com did a few years back. With well-heeled competitors like Drug Emporium (http://drugemporium.com) and pure online plays like mybasics.com already operating, the fabled "first mover advantage" is a non-factor in this race. Word has it the drugstore.com site was nearly overwhelmed with visitors on its first day. We wonder how many of them were shopping for a hot IPO rather than a cold remedy.

Whole Foods Markets, one of the newer breed of specialty foods retailer, with a focus on natural and organic grocery products, is going virtual. A visit to the site at http://www.wholefoods.com reveals a planned launch date of March 22 for its online store.

Whole Foods has 87 stores open or in development in 21 states operating under five different names: Whole Foods Market, Bread & Circus, Fresh Fields, Wellspring Grocery, and Merchant of Vino. The virtual store will bring non–perishable products to an expanded worldwide customer base. The Company says its goal is "to be the number one retailer of natural and organic foods on the Internet, just as it is in the bricks and mortar world."

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