



► THE ROAD MORE TRAVELLED: WEB TRAFFIC AND PRICE COMPETITION IN INTERNET RETAILING 1



► CEME AND SMITH MBAS TEAM UP WITH LOCAL NONPROFIT CHI CENTERS. 2



► ELECTRONIC COMMERCE INVESTING 2

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Leaders for the Digital Economy

The Road More Travelled: Web Traffic and Price Competition in Internet Retailing

Bailey, Faraj, and Yao

A recent article by CEME scholars Joseph Bailey (faculty), Samer Faraj (faculty), and Oliver Yao (alumnus) about Internet price competition has been published in the most recent edition of *Electronic Markets*, (vol. 17, no. 1). Their paper, entitled "The Road More Travelled: Web Traffic and Price Competition in Internet Retailing," is an empirical study that examines the relationship of web traffic and prices. Internet retailers often try to increase their volume of traffic by having lower price. Internet retailers with higher prices are associated with less traffic. However, is there anything that an Internet retailer can do to increase both prices and traffic? According to their study, the answer may be yes. External links--links from other web sites to an Internet retailer--may be the most valuable measure of an Internet retailer's success. Using 150 observations examining Internet retailers who carry software and/or personal digital assistants (PDAs), they find that external links are associated with greater web traffic and higher prices. This means that Internet retailers who are able to increase the number of external links are able to increase traffic to their web site and increase their

price. This is an exciting possibility for an Internet retailer who may have previously considered that lowering prices was the best way to increase web traffic. Why do links matter so much? The article describes how external links are a unique measure to Internet retailing and do more than just increase the likelihood of a visitor. It is true that many web visitors find their way to Internet retailer web sites by following links from other web sites. Moreover, this link may actually be similar to a recommendation from a friend. For example, a third party web site may describe a cool new software title or PDA that has just come out on the market. This information may be very compelling to a potential buyer and entice the buyer to potentially buying the product. If this reviewer includes a link to Internet Retailer X, it may only have to say, "I bought it from X" or "X sells it" and include a link to X. Now, the potential buyer who follows this link may have significant positive feelings for Internet Retailer X because a trusted third party has recommend them. Therefore, the buyer will be less price sensitive and the retailer can, in turn, raise price. The fact that external links are so important to Internet retailers is particularly important in light of



"An eyeball is not a customer."

some of the other variables in the study. The article finds that greater scale (carrying more products in a given category) and greater participation with shopbots (e.g. price search engines such as MySimon) are negatively associated with price and have no statistically-significant association with traffic. Greater scope (carrying more products across categories) is positively associated with price but again has not statistically-significant association with traffic. The fact that external links helps you increase traffic and price simultaneously makes it the most important factor for Internet retailers to focus on. But how? To increase external links, Internet retailers may want to find ways to encourage their customers to be vocal about their positive experiences. As customers increasingly use blogs and participate in threaded discussion groups, customers increasingly have an opportunity to voice their opinion and spread word-of-mouth about an Internet retailer they like. Loyal customers may be rewarded through a sales referral process or just a "thank you" email or coupon might do. Making your customers happy is not a new idea, but it becomes even more important now that happy customers can help drive customers to an Internet retailer's web site through external links.



CEME and Smith MBAs Team Up With Local Nonprofit CHI Centers

In the Fall 2006 semester, a team of five Smith MBA students asked the question, "How can the Internet help people with developmental disabilities?" As electronic commerce continues to grow, it is important to remember that it has still not diffused into the entire marketplace. There are plenty of opportunities remaining for electronic commerce. On such opportunity may be in helping CHI Centers find new employment opportunities for its participants. CHI Centers is a nonprofit organization helps adults with developmental disabilities. Based in Silver Spring, MD, they have been helping adults with developmental disabilities for over 50 years. Part CHI Centers mission is to find employment opportunities for their participants best suited to their skill set. These jobs range from working with food preparation to operating a printing center where participants can stuff, stamp, and label mailings. It is the printing operation that is most vulnerable as companies increasingly rely on electronic communication. So, CHI Centers turned to CEME and students in the Smith School's MBA program. As part of the full-time MBA experience at Smith, students are involved in a consulting project that is a capstone of their core classes. In this case, CHI Centers was paired with a team of five full-time Smith MBA students: Eric Grant, Guem-Tea Kim, Kumiko Kotera, Meike Reimers, and Christina Shoen. Under the supervision of Smith faculty member and CEME director, Dr. Joseph Bailey, the students began work in September 2006. After setting an action plan, they visited CHI Centers and had a chance to meet

leadership. From there, they explored a number of opportunities in growth markets that were positively affected by a transition to the digital economy. These ideas included document and photo scanning to fulfillment of electronic commerce orders. It was the potential of ecommerce that led them to Mayorga Coffee. Mayorga Coffee is a Rockville, MD-based coffee roaster with deep roots in corporate social responsibility. Most often this translates into roasting certified organic coffee made from Rainforest-certified coffee beans. This time, however, the students wanted to know if Mayorga Coffee would consider using CHI Centers for electronic commerce fulfillment. By December of 2007, the students were able to share their findings about a potential partnership between Mayorga Coffee and CHI Centers. There is some real potential but as the students point out, some real challenges as well. Because of the shelf-life of coffee and the quality that Mayorga's customers are used to, it might require such a high-velocity inventory management that it might not make sense for them to outsource to anyone. However, office coffee that is already ground and sealed has a much higher shelf life. The students recommended that such a partnership was feasible and even desirable for Mayorga because outsourcing to CHI Centers may not only help with their social mission, but it may free up their employees to focus on the freshly-roasted coffee.

For more information about these companies, check sites: CHI Centers (www.chicenters.org) and Mayorga Coffee (www.mayorgacoffee.com)



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Electronic Commerce Investing

by Tray Spilker

Are we on the verge of a second dotcom bubble? Probably not. However, investors have taken notice of several electronic commerce companies since the start of the 2007. Amazon.com's stock has risen from \$38.68 on January 1 to \$44.95 after reporting earnings on April 20; a 16.21% increase. Meanwhile, eBay's stock has risen from \$30.36 to \$33.52 over the same period; a 10.41% increase. These numbers are particularly impressive when compared to the fact that the Dow Jones Industrial Average has risen only 3.99% during this same time period. Has Wall Street decided that ecommerce stocks are ready to take flight? Perhaps the biggest explanation for the increase in ecommerce stocks stems from the 2006 holiday sales numbers. According to the Department of Commerce, 4Q sales in 2006 were up 22% from the prior year, and at 3.3% of unadjusted retail sales in 4Q 2006, ecommerce sales represent a growing portion of overall retail revenue. This has even coined a new term in retail, "Black Monday." Sure, everyone in retail knows about "Black Friday," the day after Thanksgiving when retailers finally generate enough revenue on the day to go from the red (net losses) to the black (net profits). However, consumers are increasingly staying away from the crowded malls and fulfilling their shopping lists using the Internet on Monday (or Tuesday or Wednesday) of the following week. The result? Black Monday.

So will Wall Street's holiday run continue for the publicly-traded ecommerce companies? This is doubtful. Internet retailing is, after all, retail. Retail stocks are notoriously cyclical. Yet, as Amazon.com and eBay's stock have increased 13.31% on average since January 1, WalMart and Target's stock has improved by only half that amount at 6.53% on average. Maybe the ecommerce companies are poised for another bubble after all?