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Internet and the Information Empowered Customer:

Will Price Transparency Destroy Your Margins?

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Consumers generally suffer from a condition referred to as information asymmetry, which exists when sellers have valuable information about price and quality differences that is not readily available to their customers. For example, manufacturers often know which outlets and countries offer the lowest prices for their products. Because search costs – the time and effort required – are relatively high, most consumers pay the seller's asking price. Not surprisingly, customer ignorance is often the biggest profit center in many companies.

The emergence of the Internet is slowly giving rise to what I call the information empowered consumer. Hundreds of web sites such as *www.nextag.com* use shopping robots. With a few clicks and within a few seconds, these shopping robots search numerous web retailers and display a range of prices for any particular item. NexTag not only lists the various retailers in order of price, but also allows potential shoppers to suggest a lower price if they are dissatisfied with the lowest price available. This information is then emailed to retailers asking them if they would like to negotiate a deal with the potential buyer. Mercata aggregates the purchases of multiple customers to get them volume discounts. These web sites also provide product reviews, customer satisfaction ratings for each on-line retailer, and information on availability and shipping costs. And, this information is becoming easier to obtain for the consumer. If you have *DealPilot.com* software and are about to, say, buy a book from Amazon, a box will pop up to tell you if you could get it cheaper elsewhere. Such shopping robots dramatically reduce search costs for consumers and arm them with an unprecedented level of price and quality information.

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As price transparency increases, it becomes increasingly difficult to conceal margins behind customer ignorance. Consider the automobile industry, where prices of certain models of cars can differ by as much as forty percent between the United Kingdom and the cheapest country on the Continent. The free flow of information via the Internet has revealed these price gaps to the chagrin of the British consumers. What is needed here, as in many other industries, is a complete overhaul of manufacturers' global pricing strategies. Unfortunately, when confronted with the need for fundamental transformation, companies are usually tempted to look for marginal changes that will preserve the current way of doing business. Thus most companies, wishing to protect their differential pricing systems, have either refused to publish prices on the net or have asked consumers to provide geographic information before revealing prices. Their hope is that consumer ignorance will continue to reign. However, such tactics are unsustainable in the long run. Virgin is already promising cheaper imports to potential automobile customers in the United Kingdom.

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The Internet is putting the power of global sourcing within the clicks of the individual consumer. Of course, there are technical (e.g. ability to ship products) and financial (e.g., shipping costs) hurdles that limit consumers. More distressing are the political obstacles, such as regulations and customs duties. Unfortunately, most governments seem to be fighting to protect local competitors, rather than competition and local consumers. For example, Germany still has laws that restrict the amount of discounts that can be offered on books and ban unconditional consumer guarantees. Thus, Lands End, the US retailer of clothes, is prohibited from offering its lifetime "no questions asked" return policy in Germany. Still, one has the ability to order books from *amazon.com* regardless of the country of residence. Once digital downloads become widespread, it will become impossible to track such purchases. In this sense, the Internet levels the playing field. Previously, global sourcing, with its associated cost savings and quality enhancements, was only an option for corporate buyers.

There is considerable debate regarding the impact of Internet on the balance of power in the distribution chain. Some manufacturers fear that transparency in price and quality will lower the value of their brands and turn them into commodities. Distributors fear that manufacturers will deliver products directly to the consumer and bypass them. While each of these scenarios may come true in some industries, there are certain obstacles. Most consumers buying without the benefit of touch and feel on the Internet will seek the confidence of reputed brand names. And, most manufacturers do not have the appropriate value chain to deliver directly to consumers[1]. Therefore, I personally believe that price transparency will help move power to consumers. Consumer sovereignty will finally arrive.

Retailers and the Information Empowered Consumer

1. Retailers will need to become globally competitive

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Retailing was a local business with local pricing. However, the advent of the Internet changes both the demand and the supply side. As more and more consumers become information-empowered, they will use this information to demand globally competitive prices from their local retailers. In Japan, *kakaku.com* which posts Japan's cheapest retail prices for consumer electronics items, can be accessed by Japanese shoppers through their Internet-ready mobile phones while they are shopping at physical stores. On the supply side, all that separates any retailer from a worldwide market are shipping costs and a logistics system. It will become increasingly difficult for any retailer to exist, no matter how local their business is, unless they are globally competitive. The more digital (capable of electronic distribution) and shippable (relatively low shipping costs compared to the value of the product) the product is, the greater the pressure will be. Consequently, there will be fewer, but more global winners in retailing.

2. Consolidation of the retail sector on a global scale

Over the past few years, there has been considerable consolidation in the retail sector[2]. Some recent examples include the takeover of Asda in the United Kingdom and Wertkauf in Germany by Wal*Mart; the merger of Promodes and Carrefour to create the world's second largest retailer; and the many acquisitions of Ahold, including their most recent one of the US Internet grocery retailer Peapod. Despite this consolidation, retailing is still a very fragmented business. The need to be globally competitive is going to hasten the process of international consolidation. What are the consequences for manufacturers who wish to sell through these global retailers? They will need to focus on fewer, more global brands, adopt global pricing strategies, reduce product variations, improve global account management, reorganize around customers rather than countries, and develop systems that give reports by customer, rather than by country. For most fast-moving consumer goods companies these are radical transformations for which they are unprepared.

3. Retailers should focus on helping customers buy rather than helping suppliers sell

Historically, retailers have been supplier-focused rather than customer focused. Why? Because it was, and probably still is, generally believed that the path to greater profitability lies in

[1] For a detailed discussion of this issue, please see Professor Kumar's article "Internet Distribution Strategies: Dilemmas for the Incumbent." Financial Times, March 1999.

[2] For a detailed discussion of this and other changes in the retai sector, please see Professor Kumar's article "The Revolution in Retailing: From Market Driven to Market Driving," Long Range Planning, 1997.

increasing the share of private labels, improving the supply chain, and negotiating better prices from suppliers. However, lower search costs and price transparency will force retailers to change their orientation from helping the supplier sell to helping the customer buy. One example of this transformation is the UK grocery chain Asda. On their website, they offer consumers a service which screams "Simply tell Compare_bot what you're looking for and he'll search retailer sites for you listing their prices and details so you can compare them."

4. Retailers will increasingly adopt web based EDI systems

The Efficient Consumer Response (ECR) revolution helped to improve supply chain efficiency. However, the EDI systems that were the backbone of ECR were expensive because they required dedicated hardware and software investments. Consequently, only the largest of a retailer's suppliers adopted EDI. The Internet is much more efficient in enabling manufacturer-retailer integration. Safeway, the UK retailer, allows its suppliers to login to dedicated web pages where they can view inventory and sales information for their products at Safeway stores. This will help retailers to further reduce inventory, tailor better consumer promotions and improve service.

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Manufacturers and the Information Empowered Consumer

1. Manufacturers need to rethink their pricing policies

When prices are transparent, the challenge is to be perceived as having fair pricing policies. Being fair does not mean charging the same prices to everyone, but it does mean providing, or at least having, a reasonable business explanation for any price differences. For example, unlike traditional car rental companies that have enormously complex pricing structures, *easyRentacar.com* publishes its prices on the web site. Consumers understand that prices differ based on demand and that weekends are priced higher than weekdays for this reason. Furthermore, those who book a car in advance receive better prices than those who book at the last minute. Nevertheless, everybody who logs on at the same time receives the same price. If prices have to differ across customers or countries, then prices should be based on differences in cost to serve the different groups.

2. Expect bundling and cross-selling strategies to come under attack

Related to the above comments on pricing fairness is the question of "bundling" or cross-selling strategies. For example, most large banks have their own mutual funds that they sell to customers with checking accounts. Often the performance of these mutual funds is sub-optimal as compared to established benchmarks, but customers are largely unaware of this. Today, one click at *www.cnnfn.com* or *www.quicken.com* will reveal the best-performing funds. Companies in the financial sector will increasingly have to specialize in fund management or retail banking, or become globally competitive in each segment.

3. The role of the manufacturer's sales force will change

Oracle, which recently started selling its products on the web, had to lower prices and standardize its contracts as a consequence. This has helped them save millions of dollars in sales costs and processing time. Over the next year, Oracle plans to move 80% of its sales to the web. The news is not all bad for Oracle's 10,000 strong sales force since the job will become less tedious, more challenging, and knowledge intensive for those who remain. As pricing structures are demystified and order forms for the customer are available on the web, salespersons will finally have to focus on adding real value to their clients.

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4. Manufacturers will have to learn to live with channel conflict

The ability of consumers to easily access a considerably larger set of distribution outlets through the Internet increases channel conflict, as existing distribution channels start to face competition from dealers in other territories, new on-line distributors, and manufacturer web sites. Faced with pressure from existing distribution partners, manufacturers often start making irrational decisions to protect their existing distribution channels and to avoid channel conflict. For example, many companies are refusing to supply on-line retailers directly or buying distribution outlets. However, one must have a balanced view on channel conflict by considering the following three points.

First, some degree of channel conflict is a good because it helps make resellers smarter, forces them to add value, rather than just stock and sell products. Conflict, provided it does not become unmanageable, forces the distribution channel to grow, adapt and be innovative.

"Instead of trying to protect existing distribution channels, companies should be thinking about keeping all the cannibals in the family."

Second, the manufacturer must ensure that it is represented in all the types of outlets that reach those consumer segments that are part of its target market. If this entails some competition between different types of outlets then each customer will decide which outlet provides the best service/price ratio (e.g., discounters or full service outlets).

Third, Wal*Mart is famous for telling manufacturers that as a retailer it is not their job to generate demand for any particular brand; it is the mandate of the brand owner. Similarly, it is not the manufacturer's job to ensure that a certain type of distribution survives. A manufacturer must of course treat all of its resellers fairly, but that does not mean giving identical treatment; it simply requires providing equitable treatment[3]. It is for the market to decide which distribution forms survive. Manufacturers should simply follow the preferences of distribution outlets of their target customers. Instead of trying to protect existing distribution channels, companies should be thinking about keeping all the cannibals in the family.

Conclusion

Information empowered customers and transparent prices are leading to what is now referred to as the "nude economy." While companies tend to fear this change they can also benefit from it. First, by moving procurement to the web, companies can reduce their own procurement costs. Second, with information flowing freely there will be no need for middlemen in those industries where the primary role of the middleman is providing information and establishing contacts. As a result companies can benefit from reduced costs and increased customer knowledge. Third, as inefficient firms lose out in the face of improved information on the part of their customers, the globally competitive firm will gain market share. Fourth, in certain situations, information empowered customers bid up rather than bid down prices. Prior to the emergence of the Internet, most potentially interested buyers were unaware of items on sale at auctions conducted beyond a certain geographical area. Today, auction houses can reach a worldwide audience, generate many more bids, and consequently, improve average seller prices.

Finally, there is another type of information asymmetry. Relative to sellers, individual consumers have a lot more information about their own tastes and purchasing behaviors. Now through clickstream analysis (the history of how the customer surfs the web) and collaborative filtering (more accurate data profiling of customers), sellers are becoming more knowledgeable about the individual consumer. Consequently, sellers can proactively suggest products to their customers. For example, *amazon.com* alerts a customer about the release of a new book by their favorite author. Under these circumstances, will the consumer embark on a price search or just reward the vendor for an accurate and timely "push" of appropriate products and services? Time will tell.

[3] For a detailed discussion of the concept of fairness, please request a copy of Professor Kumar's article "The Power of Trust in Manufacturer-Retailer Relationships," Harvard Business Review, November-December, 1996.

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