

E-Commerce: its potential for co-operatives

Malcolm Corbett

The internet and the Euro will turn the UK retail industry upside down, forcing prices down and service standards up - and firms that get the strategy wrong will be obliterated. We have this huge tidal wave coming towards us, and we have to decide how and when to respond. Either you do the right thing at the right time, or you get wiped out. There is absolutely no in-between.

This quote is from a speech by Sir John Banham, former director-general of the British Confederation of British Industry and chairman of retail group Kingfisher, given at the annual conference of the Computer Software and Services Association in April 1999. Sir John's statement without doubt reflects the speed with which captains of industry in the UK are catching up with their US counterparts in recognising the imminent impact of the new digital technologies on business. There is no doubt that this year is the year of electronic commerce throughout the corporate world. And some of the statistics are impressive:

- US computer giant Dell now sells US\$18m per day on-line. Overall, internet sales accounted for 30 per cent of the company's total revenue in the first quarter of the year.¹
- Internet music sales will generate US\$3.9 billion by 2004, up from an estimated US\$346 million this year, according to a report from Music Business International, MBI.²
- The online consumer travel industry will be worth US\$16.6 billion by 2003. Currently 66 per cent of US internet users research their travel arrangements online. Overall, the number of people booking on-line will increase dramatically over the next four years, to an estimated 10 per cent of the total US travel market by 2003.³
- In telecommunications, internet telephony is starting to pose a major challenge to the traditional public switched telephone network. Datamonitor estimate that internet telephony traffic will surpass PSTN traffic sometime during the year 2000. Last month Bertie Ahern, placed the first internet voice call from Ireland.⁴

- On the US stock market internet stocks continue to defy gravity. For instance internet service provider AOL is now worth US\$140 billion, more than Disney, Viacom and CBS combined (US\$131 billion).⁵

And there are plenty more statistics like these which point to what is truly a communications revolution on a par with the invention of the printing press. That revolution is still in its infancy. The technical protocols underpinning the world wide web are just ten years old.

However, whilst the corporate sector rushes to get in on the act there are voices of caution pointing at some of the problems. Richard Tomkins in a recent article in the Financial Times⁶ makes the point that "History suggests there is little chance of internet retailers ever making money by trying to offer traditional levels of service at modern-day prices." He quotes the performance of internet book retailer Amazon.com whose revenues have more than tripled in the first quarter of this year to \$293.6m up from \$87.4m a year earlier, but whose losses have increased more than five times to \$61.7m, and the trend is set to continue. Tomkins argues that whilst some internet retailers are likely to succeed - notably in travel where airlines are using sophisticated computer programs that adjust fares in real time to maximise seat take up - others, operating on essentially a mail order model are likely to fail. Historically in retail the trend has been towards ever larger physical retail outlets with ever lower selling costs and therefore prices to the consumer. On-line retailers run the risk of trying to turn back the clock, "employing people to fulfil customers' orders by picking goods off the shelves one by one, packing them ... and delivering them to customers' homes." In competition against massive supermarkets it is not readily apparent that this is likely to be a profitable enterprise - at least in the short term. But Tomkins does admit that the internet provides early opportunities for specialist suppliers through its ability to aggregate customers regardless of time or geography. So, for instance a niche supplier of rare stamps might find it difficult to make a living by opening a shop, but could run a successful on-line store catering to the needs of a geographically disparate audience.

So, who is right, Sir John Banham and his tidal wave, or Richard Tomkins and his note of caution? In a sense both. A

good example of how traditional retail and the web can mutually reinforce each other is provided, perhaps surprisingly, by the co-operative sector. Recreational Equipment Inc (REI) is one of America's most successful retailers of sports equipment.⁷ It is a retail consumer co-op with an annual turnover of US\$587m. REI is an innovative company which got into the internet early and its on-line store, rei.com, currently generates US\$50m annually (and a profit). The internet strategy has been incorporated into the whole operation - not as a replacement for traditional outlets but as a way of serving customers better. In other words REI aims to satisfy the customer wherever, whenever and however they wish to shop. REI has found that internet shoppers tend to spend more and within a year REI expects rei.com to outsell any of its physical retail stores. But it is not an inexpensive way to sell. The technology costs including staffing are far higher than equivalent store costs. For instance REI's flagship store in Seattle employs 300 people whereas rei.com employs 60. The payroll costs are, however, the same. REI has also realised that its fulfilment systems must be up to scratch with internet purchasers. They know that an old style mail order operation turnaround time of two, three, or more weeks simply is not good enough. Internet customers expect to order and receive their purchases within days. They are also addressing the issue of improving the efficiency of the whole value chain so that goods can be delivered to on-line customers profitably.

The internet headcount

E-commerce can only succeed with continuing growth in internet access. The trends are astonishing. In the UK, NOP recently estimated that 10,000 people per day are signing up. There are at least 4.3m homes in the UK connected, a number likely to increase to 9 million, or over 30 per cent, by 2002 according to the Henley Forecasting Centre amongst others.⁸ In Europe 47 million households are expected to have internet access by 2003, up from 14 million at the end of 1998. This represents an estimated 31 per cent of the total population. In Ireland an estimated 370,000 adults had internet access in February 1999, according to Amarach Consulting. This represents 14 per cent of the adult population, up from an estimate of 11 per cent in June/July 1998.⁹

Rapid growth in the UK has been fuelled by service providers offering internet access free of monthly subscription charges, just the price of a local phone call. Dixon's Freeserve was the first major offering of this type. Freeserve makes its money from a share of the telephone revenue generated by its subscribers. It also charges for telephone support and generates revenue from advertising on its portal website. Launched in September 1998, by March 1999 Freeserve boasted 1.5m subscribers, far outstripping AOL, previously the UK's largest internet service provider (ISP). Dixon's are expected to announce the flotation of Freeserve on the UK stock market and latest estimates indicate that it will be valued at around £1,500 per subscriber. Today there are around 100 free internet providers in Britain. They include a wide diversity of organisations from standard ISPs through to major retailers (WH Smith, Tesco, Waterstones and Zoom, a consortium of high street retailers), national newspapers (The Sun, The Guardian etc), even trade unions (Unison, the UK's largest union amongst others). With the advent of telecoms deregulation in Ireland, new providers will offer similar free services and drive a massive and rapid expansion in internet access. Furthermore, in future internet access will not rely solely on personal computers. The advent of interactive digital TV and new 'web-enabled' consumer devices will again multiply the number of people able to access digital information even more dramatically. It seems obvious. Even without proven business models, any commercial organisation catering to a large market would be foolish to ignore these trends.

The costs of e-commerce

The e-commerce price tag can be summed up in one word: dear. According to Gartner Group the average cost of setting up a corporate e-commerce site is US\$1m, with four fifths of the price accounted for by labour costs.¹⁰ And prices are likely to rise. These figures are borne out by the experience of rei.com who spent US\$500,000 on the initial site, and have upgraded four times in the past few months. The most recent was a US\$500,000 overhaul by IBM. They do not expect the costs to cease. One of the crucial components is developing the technical infrastructure to ensure that the whole value chain including third party suppliers can operate efficiently together to fulfil internet

purchases. Other surveys suggest lower costs, but not that much lower. The American Association of National Advertisers conducted a recent survey which produced an average price tag of US\$369,000 with maintenance costs of US\$275,000.¹¹ Meanwhile in 1998 the top 100 e-commerce sites invested an average of US\$8.6 million on building their online brand and driving traffic to their site, according to the Intermarket Group. Whichever way you look at it, this business is not for the fainthearted. Good news on the horizon is that the major IT companies are developing packaged software which will eventually drive down some of the costs, particularly the integration of on-line ordering and fulfilment processes. However, the labour costs are unlikely to diminish any time soon.

Co-operative e-commerce in the UK

CWS, the UK's largest co-operative retailer, has taken a cautious approach to e-commerce. Currently the CWS website heavily promotes the 'family of businesses' that CWS represents, and its ethical approach. Items for sale are currently limited to wine and some electrical goods. However, during a seminar at this year's Co-operative Congress, Steve Garrick from the Communications Group in Corporate Affairs, outlined CWS's approach to the internet as one of a range of 'electronic channels' including digital TV and telephone shopping that they are seeking to address. Opinion remains divided amongst the retail co-op societies on the approach to e-commerce, but things are happening and big changes are very likely during the next year. One driver will be a co-operative 'portal site' agreed by Congress. This is a movement-wide project signposting co-operation in all its forms. As this project develops it is likely to tilt the balance of opinion in favour of serious e-commerce development. After all, what is the point of attracting large numbers of visitors to a portal site if you can not engage them commercially and enhance customer as well as member relations?

Where retail co-operatives can potentially score is through their membership, an advantage which they uniquely hold. For internet marketers one of the big challenges is to attract loyal customers - even loyal surfers and their 'eyeballs'. Keeping people revisiting your site (known as 'stickiness') is regarded as crucial in a world of promiscuous consumers for whom an alternative

vendor is literally just a mouse-click away. Previously I have argued that consumer co-ops which have a direct and mutually beneficial economic relationship with members should be well placed to maintain loyalty.¹² If a member of the Wessex Co-operative Society shares in its success, it ought to be more likely that they will keep returning to buy. And the internet can enhance the relationship between a co-op and its consumer members through interactive services encouraging feedback and a sense of belonging. Although it is early days as yet some of the more imaginative co-op societies like Oxford, Swindon & Gloucester are working hard to incorporate the internet in their member development policies.

The internet and financial services

One of the biggest growth areas on the internet is financial services. 24.2 million internet users in the US are expected to bank on-line by 2002, up from 6.9 million at the end of 1998.¹³ In the UK the Co-op Bank, Lloyds and Barclays, with TSB to follow soon, all offer internet banking facilities. And all of the other major banks are planning on-line services either directly or via the internet. The Co-op Bank currently has 25,000 users of its internet banking service which it regards as a success; certainly enough to invest in a major upgrade of the service later this year. As an early adopter of the technology the Co-op Bank is well placed to learn lessons and develop the service to competitive advantage. But again, as with CWS, the internet is not seen in isolation but rather as one of a raft of new services in the Co-op Bank's future strategy including paypoint services in co-op shops, alongside counter facilities in post offices, as well as its physical branch infrastructure.

The advantages of internet banking from both the customer's point of view and the bank's are obvious. Internet users have access to their accounts on a 24x7 basis (hours per day, days per week), and unlike telephone banking, the customer is not being serviced by a call centre. However banks are not yet offering a full range of services over the internet, and perversely most do not allow communication by e-mail. Nevertheless the facilities that are being offered provide a significant benefit to customers. On the public policy front one big question is: will this increase

the trend of branch closures and withdrawal from what are perceived to be unprofitable areas leading to greater 'financial exclusion'. The answer is probably no, but as internet banking grows it is likely to impact on future investment decisions affecting the branch infrastructure.

And the credit unions?

In the UK the credit union sector is a long way behind Ireland. Growth has been hampered partly by lack of promotion and support services and partly by an unfavourable legislative environment which is only now being addressed. Meanwhile the new Labour government sees credit union development as a crucial weapon in the fight against 'financial exclusion'. The gap between high public policy expectations and reality on the ground is wide, but narrowing. In London, Social Enterprise London has developed a Credit Union Support Programme, in conjunction with (Association of British Credit Unions), to address some of the barriers to development. It is a strategic programme which aims to build capacity for credit union development through training materials for promoters, developing models of best practice, and strengthening credit unions in their start up and growth phases. A critical factor is technology support which will be provided by the Co-operative Bank. However, at this stage, the internet component is small, just a limited pilot experimenting with on-line communications in one locality. In the circumstances of the UK this is almost certainly the correct approach. Resources are unlikely to be forthcoming to invest in the technology required to engage in a larger scale experiment at present.

In Ireland the situation is very different. Whilst there is no equivalent of the Co-operative Bank to provide technical support (both banking and IT), the Irish League of Credit Unions has recently decided to support a strategy for developing a common IT platform for many of the back-end functions of credit unions. What is not apparent is the extent to which the internet has been incorporated into the strategy. Already more than 10 per cent of the Irish population has internet access. Given the changing demographics of the country coupled with telecoms deregulation and the consequent opening up of the market to free internet

services, growth in access is likely to be very rapid. If credit union members were able to access information about their accounts over the internet and to communicate with paid or voluntary staff, and with other members, the unions would dramatically increase their competitiveness whilst retaining their essential co-operative and voluntary nature. I would argue therefore that any business development strategy that does not incorporate the internet is missing one of the fundamentals.

Conclusions

Perhaps the best summary one can make about the situation today with internet commerce is that it is confused and confusing. All major retailers are trying to get in on the act, but successful strategies are, as yet, thin on the ground. Even teasing out the strategic issues is difficult. However two things that can be said with certainty are:

- Internet access will continue to grow rapidly.
- Delivering e-commerce is not cheap or necessarily profitable.

In the retail sector it is heartening to see a successful American co-op - REI - leading the way. REI got into the game early and realised that internet e-commerce adds to its channels to market, rather than replacing them, and enhances its ability to satisfy consumer demand. Co-ops can also use the internet to improve relationships with their consumer members, and this is something that is starting in the UK. In the financial sector, banks are moving rapidly to exploit internet banking. Again it is good news that the Co-operative Bank was in there early. The crucial driver is the ability to conduct one to one relationships with customers on a 24x7 basis, but with potentially lower running costs even than telephone banking. Credit unions should be able to exploit the internet for day to day business in the same way, if the cost barriers can be overcome. As financial co-operatives the added advantage is that they can use the same technology to enrich communications and therefore relationships with members - at least those who can access the internet - with limited additional running costs. If internet access continues to expand exponentially

it is likely that institutions that do not develop strategies incorporating the internet will be placed at a competitive disadvantage. It will be hard to recover.

Malcolm Corbett, is Marketing Director of Poptel Internet, a co-operative Internet Service Provider ranked in the industry's top 20. This paper was originally given at the University College Cork Credit Union Summer School, June 1999.

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