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Innovative Marketing in the E-commerce Space: A Case Study

Pallab Paul[1]

Introduction

It was an unusually warm afternoon in December 1999 as Jon Nordmark walked into his office in Greenwood Village, Colorado. As the CEO of eBags, he has for some time now been the focus of envy of a lot of people, especially, after the local newspaper reported eBags' phenomenal 25% per week growth for the past eight months. Less than two years old, eBags had been tremendously successful in the e-commerce business world. In spite of being the media's darling, Jon seemed pensive and engrossed in his thoughts. Given its limited resources, the immediate hurdle facing this fledgling company was sustenance of its present growth rate. Jon had to decide quickly what strategies would work best to continue the company's sales growth.

eBags had attained the "first mover advantage" by pioneering online sales in the bag industry. At the time when eBags entered the market, most luggage and bags were being sold through traditional "brick & mortar" retailers. A few companies also sold directly to the consumers by using catalogue-marketing techniques. However, e-trade had not yet become a fashion and no company had made an effort to establish a dominant online presence. Jon realized that aggressive marketing, extensive selection, minimal inventory, low overhead costs and low prices could work well in the bags industry, just the way it did in the books and music industries with the successful business models of Amazon and CDNow. Only, as Jon pointed out, the bag industry had several key advantages over books, music and other industries that were currently successful in the e-commerce space (see Table 1). The eBags story represented the successful execution of these advantages.

The incredible success of his venture was now haunting Jon as he struggled to keep up the growth rate. Like the majority of the start-up Internet companies, eBags had to invest heavily in technology and advertising. Although the company's revenues were growing rapidly, eBags had yet to make any profit. However, by managing the finances carefully, eBags so far had been able to hold losses at $1 million per month. But as the company grew, so did the losses. By planning strategically, eBags was trying to be profitable by the end of its fifth year (June 2003).

Jon and his management team had a great vision for their fledgling company. Their mission statement read: "eBags.com will be the world's leading online retailer and the first category killer for luggage, bags and travel-related products." Utilizing the core competency of their business (bags), their goal was to generate a well-recognized brand name, significant market share and annual revenues of $200 million by year five. They were well on their way to meeting that goal – the sales at the end of 1999 were already $6.25 million.

In order to realize this objective, the business plan of eBags described several plausible business strategies:

1. Offer the world's largest selection of luggage, bags, and travel-related products
2. Generate a compelling value proposition
3. Build a strong brand recognition
4. Develop key industry and web site alliances
5. Attain consumer loyalty by implementing dynamic 1:1 marketing techniques
6. Create loyal user communities
7. Establish an international presence
8. Raise adequate money to keep going in the short term

The Luggage Industry

In general, the "bag" industry consisted of many categories such as luggage for travel, all-purpose sports bags, specialty items like golf bags, women's handbags, diaper bags, leather wallets and related small accessories. eBags, however, was focused on a subset of this market – luggage,

[1] The author thanks Jon Nordmark, CEO of eBags, and his management team for the case information

personal leather goods (PLG) and all-purpose sport bags like duffels. In 1994, worldwide retail sales of this submarket were estimated to be $15 billion, of which $5.2 billion was in the U.S.A., $6.5 billion in Europe and the rest primarily in Asia.

Of the 1994 U.S. retail sales, only 6% ($330 million) were direct sales (manufacturer to consumer). In 1997 this grew to 12% ($634 million) (*Polk's Scout and the LLGMA*). Current online purchases amounted to less than 1% of this. But in line with the Forester Research projections for other industries, it was expected that by 2002 4% ($600 million) of global luggage and travel-related products would be purchased online (*Business 2.0, January 1999*).

Market Analysis

Jon reflected:

> *A new digital, friction-free economy is forming – a result of the Internet attracting users two times faster than the way television attracted viewers. These users are rapidly shifting buying habits and increasingly using the Internet to purchase goods and services. In addition, the Internet is expanding globally. The result will be the emergence of the world's largest distribution channel. Over the next five years, as the Internet distribution channel mainstreams, sales of items like luggage, bags and travel-related products will shift to the Internet.*

In 1997, 35 million people were online in the U.S.A. The current number was close to 50 million. By 2002, it was expected to reach 140 million in the U.S.A. and one billion globally. Mediamark Research (1998) found that 68% of the Internet users had annual household incomes greater than $50,000, 81% had attended college, and 91% were between 18 and 54 years old. The demographics were strong and enticing for advertisers and e-commerce pioneers. Already, some companies like Yahoo! had capitalized on the flow of people onto the Net.

Due to the rapid influx of consumers going online, the Internet was rapidly expanding the e-commerce environment. This mainstreaming effect was causing fast commercial acceptance. It was estimated that online consumer driven retail sales dollars in the U.S. would grow from $2 billion in 1997 to $41 billion by 2002, when 61 million Americans would purchase their goods and services over the Internet (see Table 2 for compelling reasons). The percentage of online buyers would also climb from 25% to 39% by the year 2001, claimed International Data Corporation (IDC). The latest projections from Jupiter Communications forecasted e-commerce sales to reach $108 billion by the year 2003, a marked increase over the estimates for 2002.

An increasingly broad base of products was being sold successfully online, including computers, travel services, brokerage services, automobiles and music. Companies like Garden Escape, an etailer that raised $21 million in private placement funding in June 1998, continued to expand rapidly. While an estimated 15% of all U.S. commerce flowed through direct means (catalogues, mail, phones, TV) in 1996, by the year 2012, 55% was expected to flow through non-traditional means due to the rapidly evolving friction free economy. The driving force in changing such buying patterns was likely to be the low cost global distribution channel – the Internet.

eBag's own research of consumer behavior found that the primary objection of buying luggage online was the inability to touch or feel the product. However, Jon noted that 12% of all luggage sold were on the Internet already. Unlike clothes, luggage did not need fitting or color matching. Instead, the number one search criterion for luggage was size, followed by price and other people's opinion. Consequently, eBags posted buyer testimonials on its website, effectively influencing numerous buying decisions afterwards. In addition, research showed most people did not enjoy the shopping experience for luggage in a physical store. This alone underlined the future potential of online sales.

Although the purchase was made for the entire household, the typical customer of eBags was the female head of household. The current retention rate was about 10% and the goal was to increase it to 30% in two years. A very conservative estimate of the lifetime of a typical customer was five years, with an average purchase of 1.2 pieces per year. People who traveled an average of three times a year bought luggage every four years, whereas more frequent travelers (e.g., 100,000 miles+ travelers) bought a new piece of luggage every 1-2 years. eBags intended to sell other small items (such as personal leather goods) to fill in this void and to achieve a return rate of every nine months on average.

Currently, eBag's operations primarily focused on the U.S. market. However, to capitalize on the expected rapid expansion of online retailing in Europe and Asia, Jon felt that eBags needed to move there swiftly. In particular, eBags had a former Mitsubishi employee on staff who seemed to be capable of starting the expansion process into Japan. While eBags would serve this international market through centralized operations, its investments in websites, content, marketing and technology would be leveraged over a relatively large sales base. Thus, eBags could realize significant structural cost advantages (relative to traditional bag sellers), by taking advantage of investment spending flexibility provided by online store economics. The company's focus then would be laying the foundation for far reaching distribution networks while a further goal might be to build a global brand name.

Support for such a globalization trend was reflected in a recent IDC estimate: by 2001, nearly half of all web users would come from outside of the U.S. borders, meaning big potential for companies seeking an international clientele. Even though the Internet in Europe and Asia had only one-fifth the household penetration of the U.S. in 1997, those consumers were catching up. According to the Computer Industry Almanac (CIA), Western Europe's penetration would grow from 21 million (1997) to 101 million (2000), whereas Asia Pacific plus the rest of the world would grow from 23 million (1997) to 93 million (2000). Jupiter, an independent research firm, expected global Internet sales of prerecorded music to hit $1.6 billion by 2002. Thus luggage, using industry ratios, should top $600 million by the same time globally. Jon remarked, "Web use is skyrocketing and it will dramatically change buying habits globally. The most powerful distribution channel in the world is being formed right now."

A close look at the Western European markets revealed many interesting facts. For instance, the range of the Internet penetration levels was quite wide – 2.5% in Greece to 31% in Finland (see Table 3). However, despite their medium Internet penetration levels, Germany, the U.K. and France were the three biggest Internet users in Europe (based on the number of home users online, see Table 4). Table 5 indicated the share of retail market captured by the Internet and mail order and their sizes for the Western European countries in 1998, whereas Table 6 portrayed their B2C Internet commerce trends in recent years. Finally, Table 3 depicted the credit card penetration rates in different countries, a key necessity in e-commerce.

Given all these complex data, Jon pondered whether it was worth looking into a foreign expansion. If so, the key question was which countries should be visited first? Of course, the tactical issues that would be necessary to deal with for implementing such a decision were quite difficult as well. For instance, how to set up the business in Europe/Asia? Should we joint venture with another company who is already over there or could we do it by ourselves? Where should we host the site? How about other technical issues and fulfillment procedures? Should we send people abroad to work for eBags or hire locally? What about taxes and other local rules and regulations, currency exchange issues language barriers and other cultural differences that might dictate consumer tastes and preferences?

Competition

According to Jon, the luggage industry was unique for three reasons, which in fact helped eBags create an advantage in the market place:

1) The industry had no category killer or domineering retailer
2) Selling bags the traditional way was inefficient
3) The luggage industry's private label opportunities allowed a strong retailer to eliminate the middleman and the correspondingly high mark ups from the supply chain

Jon characterized the competition the following way:

> *Most luggage and bags are sold through traditional "brick and mortar" retailers that require high gross margins to survive. Inventory turns are very slow – two times a year. Fifty million dollars worth of inventory (retail value, $28 million wholesale value) is required to conduct a typical $100 million bag business in the "brick and mortar" world. Capital is tied up; traditional retailers are unsophisticated and they expand very slowly.*

> *Beyond the slow turns, luggage is very bulky requiring a large amount of physical space for showcasing products. When slow moving inventory is combined with large space requirements, expansion of luggage-related stores is extremely slow and, thus, no category killer has emerged.*

Bricks and Mortar

Existing competition was fragmented. Traditional retailers included large specialty luggage and department stores, such as May Corporation or divisions of Federated Stores. In addition, there were a number of mass merchants and large chains like JCPenny that sold bags. Table 7 pointed out the economic and other advantages leveraged by an etailer relative to a traditional one.

Direct

Lands End, L.L.Bean, Sharper Image, the JC Penny catalogue, and Patagonia sold luggage and bags direct using catalogue marketing. Due to the cost of printing catalogues and having to share limited space with ready-to-wear, most traditional catalogues had very limited assortments.

Another group of retailers, such as QVC and Home Shopping Network, sold via television. TV airtime and sharing space with other product categories also limited the ability of companies like QVC to offer broad assortments to consumers.

Online

So far, no company had used the online store economics and sold bags through e-commerce. No luggage retailer had developed a database-driven website. No luggage retailer had formed an alliance with a major portal or with an online travel destination site. In addition, no one had developed a program that created multitudes of doors and pathways to purchase into its luggage e-commerce site. As of December 1998, Moriluggage.com and 1-800-luggage.com had purchased some key words from the search engines. However, the door was still open for a first mover.

Some non-luggage retailers sold bags, but their sites were static and difficult to navigate. More importantly, the product descriptions and pictures were not of good quality. Some examples included TravelSmith, Magellan and Sharper Image.

Jon believed:

> *The Internet provides consumers with more information, less biased information, greater search ability, better sales assistance, more personalized recommendation services, a wider selection of products, 24 hour shopping convenience, and easier access to the products and home delivery. Combined, all of these e-commerce advantages will cause consumers to gradually migrate to the Internet to shop. eBag's online business model integrates all these Net functionalities, and attractive pricing structure and enhances marketing efforts as well.*

Private label branding

Jon strongly believed that luggage lent itself to profitable and exclusive private label brand opportunities. Private label was an exclusive brand that was unavailable in other retail outlets. USA’s largest retail chain JCPenny's private label brands, Jaguar and Protocol (produced by companies like In-Gear), were the most developed in this market. These brands owned a 60% share within JCPenny's $200 million department. Costco, a 250-store warehouse club chain, sold its own private label brand Kirkland (produced by Paragon). Kirkland consisted of four SKU's, which represented about 40% of Costco's $100 million sales volume.

However, private label brands did not get advertised nationally, so brand recognition was extremely low (below 10% awareness in the U.S.A.). On the other hand, there were two primary advantages of developing those brands: better price/value to the consumer and increased gross margin for the retailer. Hence, creating private label brands could provide eBags with an edge, based on price alone (see Table 8). Jon reckoned that with a start up cost of about $50,000, a 58% gross margin on private label products (items that completely eliminated the wholesaler) was possible. These highly profitable items would still be priced about 35% lower than comparable branded products even when they were on sale. In addition, eBags was already outsourcing some items for its corporate clients (such as some airlines) to manufacturers in the People's Republic of China, Philippines and Thailand. These small companies abroad were capable of producing the highest quality products at the lowest price and could be part of a strategic alliance with eBags if it wanted to build its own brand.

Despite the possibility of a huge profit margin and name recognition, developing a private label brand of bags could be a challenge. eBags first needed to become a leading brand name in online commerce. The company's current brand recognition strategy should help. It attempted to promote, advertise, and increase its brand equity and visibility through excellent service and a variety of marketing and promotional techniques, including advertising through leading websites and other media, conducting an ongoing public relations campaign, and developing business alliances and partnerships. Next, eBags had to contend with the possibility of conflicts with current suppliers. Some of them would not like this merchandising strategy at all as it would compete directly against them. As it was, eBags relied heavily on suppliers because the majority of its products were drop shipped directly. Finally, eBags had to consider what its growth strategy would be. Jon would like to have this private label account for almost half of its business in future. Would it be possible and how?

The Company

Given the current situation in the bag industry, Jon perceived an ideal opportunity for an etailer business concept:

> *eBags is ideally positioned to be the cyber-world's category killer of travel-related products. eBags will succeed by becoming the bag industry's gold standard for <u>marketing</u> and <u>merchandising</u> an extensive 10,000 item selection. Combining <u>minimal inventory</u> with <u>low overhead costs</u> will result in <u>low prices</u> and <u>outstanding margins</u>. This will lead to <u>rapid sales growth</u> and a <u>very profitable business</u> that will begin to rewrite the industry's value equation.*

eBags was a classic example of a company that started with just an idea and grew over time. Its founder, Jon Nordmark worked for Samsonite, a major U.S. manufacturer of luggage products, for ten years. During this time, Jon launched and managed every business aspect of the product life cycle for 1,200 Samsonite products. But in early 1997, when Jon proposed selling Samsonite products online, the company declined. Jon spent his own money to write the initial business plan for eBags and was able to recruit Frank Stead, Andrew Young and Peter Cobb (all former colleagues at Samsonite). Peter's brother Eliot Cobb joined as well and together they founded eBags in March 1998. They all worked for free for the next eight months till January 1999 when eBags received its first funding. Under the stewardship of Mike Frazzins the website was ready for e-commerce in March 1999 (four months later than expected) and since then the company had been on a roll. As of December 1999, eBags was worth $137 million (twice the value of Samsonite) and employed 59 people.

Jon attributed much of the success of this start up to the teamwork and the right chemistry of this management team. They all worked together in Samsonite for a long time and knew the luggage business inside out (and each other as well). In addition, each founder brought in professional skills that were complementary to others and no outside help was needed (except for technical area for which Mike Frazzins was hired and seemed to be the "right guy"). Jon was the "idea" guy, whereas Frank, Peter, Andrew and Eliot were the operations, marketing, merchandising, and finance types, respectively. Even though Peter and Eliot were related, they kept it outside the business and this did not cause any shift in powers among the five main players.

The Site

According to Jon Nordmark:

> *eBags strives to offer the ultimate online shopping experience for consumers. The company believes that the sale of luggage, bags, and other travel-related products over the web can offer several attractive benefits to*

consumers. eBag's website created a compelling value proposition for consumers, quickly offered the world's largest selection of luggage, bags, and travel-related products, and built its brand name.

Convenience

Convenience was the primary reason people shopped on the Internet. eBags delivered 24 hour, 365 day shopping plus home delivery worldwide and thus created value for its customers. Customers in any part of the world, including rural, or other locations that could not support large-scale physical stores, had access to any merchandise they needed, eliminating time-consuming shopping trips to crowded malls. In addition, the delivery of large, cumbersome, bulky items to a customer's doorstep or office was seen as a valuable benefit to many customers. Customers perhaps bought more bags because they had more hours to shop, acted immediately on a purchase impulse and could locate bags that were hard to find.

Selection

An online bag seller had virtually unlimited online shelf space and could offer customers a vast selection sorted and ranked easily through an efficient search and retrieval interface. eBag's dynamic database-served website offered more than 2,000 SKU's by the end of 1999 – the world's largest selection – growing to more than 10,000 SKU's within five years. This wide assortment provided compelling value by saving time for consumers who no longer needed to shop from store to store. For comparison purposes, a typical luggage specialty store carried 10% of eBag's assortment; a typical department store carried 2%-4% of eBag's offering; and a typical mail order company carried only 1% of that of eBags.

At present eBags was focused on selling only core branded products, while private branding was a distinct possibility for the near future. It sold well known brands such as Travelpro, Samsonite, American Tourister, JanSport, Atlantic, High Sierra, Kelty and Benneton (see Tables 9 & 10 for a complete list of styles and brands) for as much as 25% below traditional store price. eBags took advantage of the branded "discontinued" product as much as possible, producing significant consumer savings. Its gross margins were maintained through aggressive purchasing opportunities.

Currently, eBags was selling 23 different brands from 15 vendors and had plans to add more. In the future, one vendor at a time would be added until all segments within each category were satisfactorily covered for all consumer shopping preferences. eBag's strategy was to manage growth in order to ensure that careful and proper order fulfillment requirements were met and at the same time, maintain a strong relationship with the suppliers.

However, there were several challenges that eBags was grappling with. Jon found it was extremely difficult to bring in the top-tier brands online with eBags. They were hesitant mainly because of their existing relationships with top specialty stores, the great distribution systems in place and their brand image. Many of them would not sell to stores outside their distribution system – e.g., Coach would not even sell to May Company. They had no reason to use the Internet or the service of eBags. Perhaps, eBags could use a pull strategy, where customers demanded their brands online, to get them on.

Prices

Pricing was continually monitored by eBags, and highly competitive prices were offered. The $1.8 billion U.S. luggage market typically required 40%+ gross margins to operate (*MOR of Department and Specialty Stores, 1993*). Financial analyses (Table 11) showed that eBags could operate very profitably even on 36% gross margin in year five. This 36% gross margin even incorporated the fact that a number of premium brands (e.g., Briggs & Riley) commanded 50% or higher margins. eBag's margin structure allowed it to be very flexible and competitive when establishing prices.

Personalization

eBags.com offered a highly refined personalized search and recommendation service – another value-added service. The search service currently available could be drilled down to any combination of category, brand and price, while accessing an interactive, searchable catalogue of more than 2,000 SKU's. The search tools also retrieved bags based on consumer suggestions, expert (pilots, flight attendants) recommendations, probable use patterns, or recent introductions. Whenever a consumer requested personalization, eBags provided between three and ten recommended product picks depending on the product specific criteria entered by shoppers.

Once a consumer filled out a search criteria form, critical parts of the information were stored on eBag's database. When this particular client reentered the eBag's website, this information was used to personalize web pages, to customize advertising messages; to tailor 1:1 marketing correspondence. Furthermore, higher personalization and better targeting of product and service offerings attracted advertisers to the eBag's site.

Content

eBags offered numerous reviews and content from experts and consumers in order to entertain and engage readers, enhance the shopping experience, and encourage purchase. In particular, pilot and flight attendant interviews were presented, along with reviews from other professional sources on topics like:

What pilots looked for in wheels
How a flight attendant packed for four days
Essentials one might not think about
Carry-ons that fit airline requirements best
Which customers made flying difficult
What features were best in a tote bag
The brand one liked best

Bag designers were invited as well to talk about the bags they designed. Often, there were interesting stories or testimonials that might be of interest to a person making the final bag selection.

In addition, various types of content were available for each brand and style. Most importantly, customers were encouraged to write their own testimonials of which some were posted on the website. Consumers were invited, via electronic mail, to evaluate bags after purchase and usage. This information was made available to potential consumers visiting eBag's site, creating a unique level of information and trust. This was a service traditional bag retailers could not provide.

Browsing

Beyond offering personalized search mechanisms, eBag's site made it easy to simply browse through a wide array of relevant content. It offered visitors a variety of highlighted subject areas and special features arranged in a simple, easy-to-use fashion intended to enhance bag search, selection and discovery. Clicking on an item provided an information rich content page with a variety of photographs of the item and its key features. Clicking on any image enlarged it to the full size of the user's screen for careful review. The item page included links to more relevant information about the featured bag (consumer ratings, descriptions and testimonials, suggestions for matching items), as well as a button that added the bag to the shopping cart.

Ordering

Customers were able to add and eliminate bags from their shopping carts as they browsed, prior to making a final purchase decision (just as in a physical store). To execute orders, customers clicked on the "check out" button and were prompted to provide shipping and credit card details. This information was stored on the company's secure server and was not needed again for a repeat purchase. The personal password allowed repeat customers to automatically access their previously provided shipping and credit card information, as well as their luggage and travel profiles. eBag's system automatically confirmed each order by email within minutes after the order was placed. Furthermore, customers received a secondary email shortly after their order was shipped. By utilizing eBag's customized inquiry capabilities, buyers were able to track their order from the time it was submitted until the moment it reached their doorstep.

Marketing

So far, the company's marketing efforts had been primarily directed towards building brand awareness and increasing site traffic. Other objectives included creating consumer loyalty through 1:1 marketing efforts, establishing thousands of travel-related links into eBags and developing a highly interactive travel community website, *LetsTalkTravel.com*.

eBags, like CDNow and Amazon, tried to exploit an opportunity to gain "first mover" status and mainstream its brand name. It already invested high percentages of revenues in advertising and marketing, hoping that it would capture higher revenue, profit and market share as the Internet channel matured. The company activated a variety of marketing tools, like advertising, strategic alliances, and public relations, designed to make eBags the dominant worldwide etailer of luggage, bags and travel-related products (see Table 12).

Lately, eBags was in the process of partnering with a name brand interactive advertising agency, such as Leftfield, Kirshenbaum Bond & Partners, and I-traffic. Besides acquiring customers, these agencies helped eBags (a) establish brand positioning, (b) identify and test partnering and location opportunities, (c) develop and execute a portal strategy, (d) suggest and implement a destination site strategy, and (e) determine compelling product and service messaging.

Operations

Jon and his management team realized that in order to become the market leader, eBags had to have the most efficient and effective operations possible. To that end, eBags had pursued the following principles:

Customer service

eBags established and maintained long-term relationships with its customers and encouraged repeat visits. Numerous e-mail addresses were provided to enable customers to request information and encourage feedback and suggestions, so that eBags could continually improve its services. In addition, its team of customer support and service personnel were responsible for handling general customer enquiries, answering questions about the ordering process, and investigating the status of orders, shipments and payments. For customers who were reluctant to enter their credit card numbers through the website, the company offered a toll-free line.

Warehousing and fulfillment

Majority of items were drop shipped directly from the supplier to the consumer. eBags carried minimal inventory and relied to a large extent on rapid fulfillment from major and minor suppliers. In some cases, it purchased limited inventory of the fastest selling SKU's to ensure timeliness and high customer fill rates. In other situations, eBags purchased some inventory of backpacks and daypacks because that industry was in the process of learning how to drop ship items individually. All suppliers also had relationships with UPS, eBag's shipping provider.

Technology

eBag's strategy was to build a dynamic, database fed site. It used a set of applications for accepting and validating customer orders, organizing, placing and managing orders with suppliers, receiving product and assigning it to customer orders, and managing shipment of bags to customers based on various ordering criteria. The company's transaction processing systems were built to handle thousands of items, availability status, and multiple shipment methods. These applications managed the process of accepting, authorizing and charging customer credit cards. In addition, it allowed eBags to maintain ongoing automated email communications with customers throughout the ordering process at a minimal incremental cost.

Such a system also automated many routine communications, facilitated management of customer email inquiries, and allowed customers to self check their order status, change their email addresses or password, and check subscriptions to personal notification services. eBags valued frequent feedback from its customers and this system enhanced this capability. A variety of search and database tools were incorporated as well.

The transaction-processing system was integrated with the accounting and financial systems and was fully automated. This ensured that the current management information system produced frequent operational reports more efficiently than traditional accounting oriented reporting. Three state-of-the art servers were purchased from NEC, which handled the processing needs of the website. Systems administrators and network managers monitored and operated the website, network operations, and transaction processing systems. Continued uninterrupted operation and reliability were eBag's critical business assets.

Human resources

At the end of year one (June 1999), eBags employed approximately 50 full time people (compared to 92, employed by CDNow in early 1998). Many of the employees were responsible for establishing the necessary alliances needed to drive traffic to the eBags site. As the company grew, eBags hired more and more people and expanded its physical operations in Greenwood Village, Colorado.

Financials

> *A killer app is a new good or service that establishes an entirely new category and, by being first, dominates it, returning several hundred percent on the initial investment. Invariably, killer apps wind up replacing unrelated older offerings, destroying and recreating industries far from their immediate use, and throwing into disarray the complex relationships between business partners, competition, competitors, customers and regulators of markets" (Killer App, 1997).*

As stated in the financial projections (see Exhibit XI), eBags was determined to attain profitability in year five, when its revenues would reach $200 million, with a market capitalization of $1 billion. As of December 1999, eBags had a revenue of $6.25 million and was growing at 25% per week. In January 1999, the company received $650,000 in seed and start up capital from its five founding members and some additional funding from a Goldman Sachs Partner and other private investors. Afterwards, it completed a second round of financing (raised $8 million) and has been currently in the process of raising another $22 million. These funds would be used as further startup capitalization to enhance the website, secure the necessary strategic links and alliances, conduct an offline advertising campaign, hire the necessary staff, and implement expansion plans. Finally, eBags had plans to become a public company by going through an IPO at the beginning of the third year.

A very large challenge was to decide when and how to do an initial public offering. Going public had its downside as the company would have to disclose proprietary information to the public. Once the business model of eBags was revealed, other companies might copy them (creating a price war on the Internet) or larger companies might try to take eBags over. Jon was confident that he could indeed raise about $50 million in an IPO, but was it worth the uncertainties that eBags might face in the future?

What's Next?

While everything seemed to move smoothly, Jon was concerned about managing the continued growth rate in sales. What were the right strategies that eBags needed to pursue to maintain its phenomenal growth rate and become profitable soon? Several options came to his mind – perhaps growth through improving current marketing tactics (including more efficient and effective e-marketing considerations). Alternatively, it could be through geographic expansion (the international opportunities) or through product line extension (e.g., private labeling, adding more vendors). The dilemma for Jon, then, was to analyze these alternatives (and any other that he was yet to think of) and determine which was likely to be most beneficial to the company. Jon knew that in order to stay ahead of the game, he needed to make some decisions soon.

Appendix

Table 1

eBags companies

	Factor	Books	Music	Bags	Comments on eBag's advantages
1	Competition	Amazon Barnes & Noble Borders Group	CDNow Blockbuster Musicland	Negligent	No national chain that focuses exclusively on bags
2	Gross margin	22%	15%	23%	High gross margin can be achieved while still eliminating inventory and having outstanding consumer prices
3	Pricing	Up to 40% off	Small savings because of slim retailer markups	Up to 50% off	Even at a high 23% margin, a completely online bag retailer is capable of pricing significantly below the best sale prices offered by specialty and department stores
4	Private label opportunities	No	No	Yes	eBags can create its own brand and advertise it globally
5	Number of online competitors	15,000 book sites	28,000 music sites	248 luggage sites	Of the luggage sites online, all are static and many provide information only. None is dynamic
6	Transaction cost	20% of total payment, assuming an average purchase of $20	20% of total payment, assuming an average purchase of $20	10% of total payment, assuming an average purchase of $100	Overall transaction cost (shipping and handling, and credit card transaction charges) is much lower as a percentage of total price paid
7	Number of SKU's	3,000,000 (Amazon)	250,000 (CDNow)	10,000 (eBags)	With far fewer SKU's, eBags will still have a very broad assortment (for comparison, JCPenny has only 160 SKU's)
8	Employee base	600 (Amazon)	N/A	150 (eBags)	Fewer people are needed to run the luggage business
9	Sophistication	High	High	Low	Bag industries are less "glitzy", which means lower competitive pressure and more opportunity to add excitement and newness to the industry

Table 2

E-commerce advantages

Consumer benefits	Why people buy on the Net
Convenience	66%
Avoiding crowd	44%
Price	42%
Finding items not available locally	39%
Selection	26%
Speed and delivery	19%

Table 3

eBags euro penetration

	Internet penetration levels, 1998	Credit card penetration levels, 1994	Credit card penetration levels, 1995
	%	Cards/1000 inhbitants	Cards/1000 inhbitants
Austria	11	501	548
Belgium	8	881	932
Denmark	21	543	563
Finland	31	620	625
France	6	385	406
Germany	13	582	911
Greece	3	103	136
Ireland	8	273	341
Italy	5	313	351
Netherlands	16	82	97
Norway	24	N/A	N/A
Portugal	5	684	720
Spain	5	819	792
Sweden	26	1375	1535
Switzerland	15	N/A	N/A
UK	15	934	1012
Total Europe Average	11	580	657

Source: IDC and Eurostar.

Table 4

Internet users in Europe

	1997	1998	1999 (estd.)	2000 (estd.)	2001 (estd.)	2002 (estd.)
Austria	240	530	880	1 300	1 740	2 150
Belgium	230	460	750	1 150	1 700	2 410
Denmark	360	660	950	1 240	1 520	1 760
Finland	710	1 000	1 230	1 480	1 770	2 080
France	1 040	2 110	3 670	6 120	10 010	15 740
Germany	3 080	5 980	9 280	13 140	17 420	21 840
Greece	60	120	210	330	490	690
Ireland	90	180	280	400	550	720
Italy	770	1 670	2 850	4 340	6 110	7 970
Netherlands	770	1 470	2 260	3 210	4 290	5 450
Norway	320	600	870	1 140	1 370	1 550
Portugal	100	220	380	580	840	1 120
Spain	440	1 020	1 830	2 140	3 920	4 860
Sweden	820	1 560	2 350	3 160	3 930	4 610
Switzerland	320	620	960	1 370	1 820	2 300
UK	2 870	5 310	7 840	10 530	13 280	15 870
Total Europe	12 220	23 510	36 590	52 330	70 760	91 120

Source: IDC.

Table 5

Share of retail market captured by the Internet and mail order and their sizes for the Western European countries

	Total Retail	Mail Order	B2C	Mail Order	B2C
	$B	$B	$M	%	%
Austria	34,1	1,7	50	5,0	0,1
Belgium	33,6	0,7	22	2,0	0,1
Denmark	31,7	0,9	37	2,8	0,1
Finland	23,9	0,6	54	2,7	0,2
France	328,1	9,9	88	3,0	-
Germany	416,2	28,7	651	6,9	0,2
Ireland	13,0	-	13	0,2	0,1
Italy	347,6	0,8	72	0,2	-
Netherlands	67,9	1,4	122	2,1	0,2
Norway	25,5	0,9	46	3,5	0,2
Spain	99,6	0,8	32	0,8	-
Sweden	32,5	1,2	102	3,5	0,3
Switzerland	51,7	1,6	59	3,0	0,1
UK	273,2	10,4	502	3,8	0,2
Total Europe	1 778,4	59,4	1 850	3,3	0,1

Source: Marketing Logistics Inc., IDC, GS estimates.

Table 6

B2C Internet commerce trends

	1997	1998	1999 (estd.)	2000 (estd.)	2001 (estd.)	2002 (estd.)
Austria	13	50	153	360	750	1 360
Belgium	6	22	68	170	380	770
Denmark	10	37	108	250	530	990
Finland	18	54	136	280	540	940
France	21	88	337	1 040	2 860	6 870
Germany	180	651	1 863	4 230	8 550	15 340
Greece	1	4	12	30	70	140
Ireland	4	13	39	90	200	380
Italy	18	72	229	570	1 260	2 430
Netherlands	34	122	339	750	1 470	2 590
Norway	13	46	130	290	570	1 010
Portugal	1	6	18	50	100	190
Spain	8	32	107	270	600	1 150
Sweden	28	102	285	630	1 230	2 160
Switzerland	16	59	172	400	820	1 490
UK	142	502	1 402	3 110	6 140	10 810
Total Europe	513	1 860	5 398	12 520	26 070	48 620

Source: IDC.

Table 7

eBags bricks comanies

	Bricks & Mortar	eBags.com	Potential Savings
Number of stores	200	1	99%
Number of cities	40	10 000	
Number of employees	3000	213	93%
Number of SKU's	400	10 000	
Annual revenues	$200 000 000	$200 000 000	
Cost of products sold	$110 000 000	$128 000 000	
Cost to build these stores	$60 000 000	$1 000 000	99%
Cost to update/remodel these stores	$6 000 000	$2 000 000	67%
Cost to lease retail space/servers	$20 000 000	$1 500 000	92%
Cost of employees	$50 000 000	$13 500 000	73%
Capital tied up in potential inventory	$68 000 000	$3 000 000	96%
Capital leftover to advertise	$2 000 000	$35 000 000	

Note: eBags will initially compete with the traditional establishments that have physical stores. This table compares two retailers generating $200 million in revenues, one online and the other traditional. The findings clearly demonstrate the unique benefits acquired by an etailer.

Table 8

Private label brands

	Typical branded product	Private label opportunity
Suggested list price	$300	$300
Promotional retail price	$199	$99
Wholesalers' selling price to the retailer	$100	
eBag's Cost of sale, after freight, duty & other	$55	$55
ebag's FOB Far East, price paid to Far East manufacturers	$35	$35

Table 9

eBags styles

Current styles and products carried	
Carry-ons	Adventure gear
Garment bags	Kids
Business cases	Computer cases
Backpacks	Duffels
Sport bags	Accessories
Suitcases	Uprights
Future categories under consideration	
Ski bags	Wallets
Hockey bags	Women's handbags
Totes	Agendas
Writing instruments	Sunglasses
Bike racks	Bike bags (Paniers)
Travel clothing	Dopp kits

Table 10

eBags brands

	Current brands and vendors	Business segments			
		Luggage	Business cases	Accessories	Bags
1	Travelpro (top brand choice for flight attendants, mid-top tier brand)	x			
2	Samsonite (global luggage leader, 92% brand awareness in USA)	x	x	x	
3	American Tourister (#2 with 78% brand awareness in USA)	x			
4	JanSport (a $200m manufacturer of bags, daypack market leader)		x	x	x
5	Atlantic (Samsonite's top competitor)	x			
6	Eastpak (a second top brand for student school bags, after JanSport)			x	x
7	Ricardo (Costco's chief product source, a strong opening price point)	x			
8	Skyway (another strong opening price point brand)	x			
9	Briggs and Riley (a premium brand)	x	x	x	
10	Lark (high-end Samsonite, owned by Samsonite)	x			
11	Kenneth Cole (upscale business cases and luggage)	x	x		
12	Heritage (#1 in business cases with 50% share of USA market)		x		
13	Jourdan (second tier but established business case maker)		x	x	
14	High Sierra (mid-priced casual bag maker)		x	x	x
15	E&B Giftware (travel accessories marketer, licenses Samsonite name)			x	
16	Kelty (leader in technical outdoor bags)			x	x
17	Kelty Kids (highly innovative kid's gear)			x	x
18	Pangaea (adventure luggage specialist)	x		x	x
19	In-Gear (lower priced sporty products)	x		x	x
20	Frozn (specialty cooler bags)			x	
21	Iron Man (low cost luggage)	x			x
22	Champion (sprort bags)	x		x	x
23	Benneton (fashionable accessories)			x	

Table 11

eBags financial analyses

	Year I	Year II (estd.)	Year III (estd.)	Year IV (estd.)	Year V (estd.)
	30.June 99	30. June.00	30. June.01	30. June.02	30. June.03
Annual traffic through site	223 164	2 586 513	9 803 926	20 457 503	35 744 454
Daily traffic through site	1 240	7 185	27 233	56 826	99 290
Conversion rate	1,8%	2,4%	2,8%	3,0%	3,1%
Total units sold	6 660	105 400	465 256	1 044 579	1 910 343
Units per day	37	293	1 292	2 902	5 307
Average unit price*	133,75	125,00	113,75	108,75	108,75
Average unit cost*	88,32	80,10	70,64	64,78	66,42

Table 11 (continuous)

	Year I	Year II (estd.)	Year III (estd.)	Year IV (estd.)	Year V (estd.)
	30.June 99	30. June.00	30. June.01	30. June.02	30. June.03
Average unit margin*	45,43	44,90	43,11	43,97	42,33
Margin percentage*	34,0%	35,9%	37,9%	40,4%	38,9%
Net sales	845 357	12 558 395	50 781 109	109 367 950	200 013 859
Cost of goods sold	648 151	9 180 340	35 191 963	70 801 564	127 992 981
Gross margin	197 206	3 378 055	15 589 146	38 566 386	72 020 878
	23,3%	26,9%	30,7%	35,3%	36,0%
Payroll	925 710	3 768 133	5 295 250	10 264 550	13 455 300
Advertising and alliances	2 100 036	7 510 322	10 673 295	22 623 564	35 673 256
Other costs**, ***	746 783	2 245 436	5 547 814	10 277 036	14 567 111
Total S, G & A	3 772 529	13 523 891	21 516 359	43 165 150	63 695 667
Income (loss) from operations	-3 575 323	-10 145 836	-5 927 213	-4 598 764	8 325 211
	-422,9%	-80,8%	-11,7%	-4,2%	4,2%
Headcount at end of year	49	79	114	168	213
Cash	4 778 705	1 671 455	53 459 784	59 578 672	85 129 711
Property, plant & equipment	857 333	802 944	1 637 444	2 842 778	3 373 667
Total assets	7 645 907	8 262 648	62 253 128	68 542 932	93 195 954
Liabilities	952 863	2 142 319	7 779 901	11 960 806	25 730 651
IPO			48 946 335		
Pro forma market capitalization			253 905 545	546 839 749	1 000 069 294

Note: All figures are in USD. Some figures have been disguised to protect the company

* before discounts, returns, freight & fulfillment

** includes $1.5m for development of Europe in year III. Also includes initial staffing costs. Total development costs for Europe including website = $2.5m.

** includes $2m for development of Asia in year IV. Also includes initial staffing costs. Total development costs for Asia including website = $3m.

Table 12

eBags marketing budget

	1999	2000 (estd.)	2001 (estd.)	2002 (estd.)	2003 (estd.)
Advertising	300	1 800	3 000	7 350	12 000
Alliances	1 211	4 370	4 809	9 873	15 333
Public Relations	152	400	500	500	500
Other marketing	390	570	860	1 650	2 000
Total	*2 053*	*7 140*	*9 169*	*19 373*	*29 833*