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## The End of E-Tail: Netting out Priceline's Prospects

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### Abstract

Is the end of e-tail upon us? Anyone reading the business page recently—particularly coverage of Priceline.com's latest round of layoffs and aborted overseas expansion coupled with its decision earlier this fall to shutter its online gasoline and grocery shops—might think they'd thumbed over to the Obituaries by mistake. However, opportunities still abound. E-tail is just beginning.

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To be sure, with Priceline trading at \$2.25—a 98 percent drop from its 52-week high of \$104—Wall Street's brand of name-your-price trading has put pallor on the cheeks of the online e-tailer. Yet Priceline's share-price plunge notwithstanding, reports of e-tail's demise are greatly exaggerated. What's happening with Priceline happens everyday to companies that chase markets that don't make sense for them. The advent of the Internet didn't repeal the Laws of Economics. Online or offline, some market niches are suited to the reverse auction model. Some are not.

Reverse auctions—in which consumers put their price out for bid to a variety of producers—work perfectly well for perishable products, just not the perishables we think of when we think of grocery stores. Forget fruit and vegetables—realize that a clever grocer can sell even a blackened banana—provided he puts it in a paper bag with a banana bread recipe printed on the bag. If you really want to understand the concept of purchase or perish, consider an airline seat. If no one's sitting in 4C when Flight 212 departs for Albuquerque at 2:32 p.m., the chance to sell that seat is gone forever.

Consider the marginal cost of putting a person in that empty airline seat, which is near zero. After all, the airline has to clean and fuel the plane and staff it with a flight crew whether seat 4C is empty or not. So other than the cost of an airline meal (and really, how much could that be worth?) the marginal cost of putting a paying passenger in that seat is almost nothing. Add in the fact that in the information-intensive airline industry, airlines not only know their spare capacity—they forecast it. If Priceline says it can put a passenger in that empty seat—even for a cut-rate price—what airline wouldn't be interested?

The same "use or lose" dynamic holds true for hotel rooms. In contrast to day-old bread, rooms that stand vacant tonight are worth nothing the next morning. Like factories that need to operate as close as possible

to full capacity because of their high fixed costs, airplanes, hotels, rental car companies, cruise lines, even African safari outfitters have a huge incentive to defray fixed-costs by selling more of their low-cost marginal units. For safari outfitters, Priceline's reverse-auction model is the perfect way to work the slack out of their system (and recoup fixed costs) for perishable goods with low marginal costs.

By the same logic, the Priceline model doesn't have much to offer grocery stores, which has a limited inventory of perishable goods. Walk the aisles in your neighborhood supermarket. From canned goods and cereal to light bulbs and floor wax, the shelves are stocked with non-perishables. The same is true for gasoline—especially now, thanks to OPEC—which has shelf value. Groceries and gasoline have a fixed cost of production and retain value. These niches do not represent perishable goods with low marginal costs.

It helps when the perishable product or service is a predictable "commodity," like flying on any major airline, where the inflight experience is largely interchangeable. Reverse auction is less attractive if you're considering getting a haircut or your teeth cleaned—or hiring a business consultant. The growing number of web-based legal service sites makes the point that many services are not commodities. It is one thing to surf for fixed-price legal help for preparing a basic will or executing a no-fault divorce, but how many people are ready to put out a bid for low-price legal assistance to execute an LBO?

Measured by those yardsticks, it's hard to see how selling cars meets the "perishability" factor, which should send up flags for Priceline or other reverse-auctioneers. By the same token, maybe Priceline could auction perishables, such as concert or sports tickets, and theme park, and theater or movie tickets too.

All of which is to suggest that Priceline's blunder wasn't getting out of the grocery and gas business, but entering those segments in the first place. Better to leave that sector to the Peapods and Webvans, whose model is to sell people convenience, in the form of fresh milk delivered direct to your fridge. Rather than assuming the coporation can sell so many different kinds of products through reverse auction, Priceline should have thought more deeply about the characteristics of the goods and services that would best work for their model—the way Jeff Bezos decided to start Amazon.com with books after considering other categories and concluding that books were better suited to B2C ecommerce than just about any other product.

Will Priceline fend off an online onslaught mounted by a ticket-selling consortium cobbled together by the airlines and upstart reverse-auctioneers like Savvio.com, which is eyeing both airline tickets and cruise ship berths? Only time—measured in Internet weeks—will tell. Meanwhile, e-tail enthusiasts of all stripes should learn a lesson from Priceline. No matter how "New" the economy, the old laws of economics still apply. The business model you select needs to fit the product or service categories you offer.

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*Editor's remark:*

*While I agree with the author, Pierre Loewe, on his perceptive market analysis, I have introduced some conflicting thoughts in the interest of readership discussion. There are conspicuous secondary and tertiary effects from the auctioning of perishable marginal-cost units. The Edgeworth (box) zero-sum concept means the sales of empty seats in an auction undermine sales efforts at other airlines. In particular, the FAA (with foreign regulators) creates an oligopoly in air travel with restrictive flight plans, routes, and traffic control thus establishing limits to new entrants and competition and adding significant fixed-costs for new capacity. A tertiary effect derives from people with the opportunity to game against the system when a round-trip flight from NYC to LA costs \$850 but possibly can be had for \$137. Even business people will affect opportunistic business travel, shifting the base economics of the system as a whole. In addition, an airline, perhaps an airline that cannot expand with gates and flights, could buy competitor seats just to force a last minute traveler to its open seats at much higher process. An airline or the entire industry could refuse to sell open seats at auction because the statistical value of a*

*few high-priced sales offset any gain and perception of cut-rate travel. Consider the emotional value of a once-in-a-lifetime \$7000 cruise versus a \$450 cabin. The monopolistic policy of De Beers artificially maintains high diamond prices for that reason. In contrast, any "free" and unregulated market is more complex than it seems, as shown by the number of options, hedges, and derivative products availability in the greatest auction market of all, that of the world financial markets.*