



## Bessemer's Top 10 Laws of E-Commerce

October 2010 Release

### INTRODUCTION

The dot-com bubble is long behind us, but online commerce is finally red-hot again. In the late 1990s, the conventional wisdom was that the transformation from “bricks to clicks” for retailers would happen almost instantly. Yet over the past ten years, it’s become clear that the shift to the Web was not a two- to three- year *revolution*, but a 15-20 year *evolution*.

According to comScore, non-travel/auto/gas/food e-commerce sales represented just 7.1% of total retail sales in the US in Q2 2010. But, significantly, online sales have grown at an annualized rate of 9.7% since 2006 (vs. the 2.3% annualized *decline* in total retail sales over that same period, which includes the Great Recession). Leading online retailers, like Amazon.com, are growing even faster—30% per year for the past several years. This growth in e-commerce should only accelerate.

Companies like Zappos, Bessemer portfolio company Quidsi (operator of Diapers.com and Soap.com), Vente Privee, Netflix and others are creating new online-retail categories and pulling offline dollars onto the Web. But a lot has changed since the heady—and money-losing—days of eToys and Pets.com. Today’s successful e-commerce sites don’t just throw products up on a Web site and spend tens of millions of dollars on traditional brand advertising to promote them. The rules of the game today are much more complex and, in many ways, scientific: They involve astute use of targeted, direct-response advertising, for instance, and careful calculations about the lifetime value of each customer. Those leading the e-commerce pack today also display a laser-like focus on customer service, including offering fast and/or free product delivery. (Consider Zappos, which ships customers their shoes overnight.)

At Bessemer, we’ve been lucky to have participated in each successive wave of retail innovation since the mid-1980s, starting with our investments in “big-box” retailers like Staples, The Sports Authority, Dick’s Sporting Goods and Eagle Hardware & Garden. In the late 1990s, we funded several first-generation Internet retailers. Some of these early-stage investments, like Blue Nile,

became successful public companies and went on to embody the initial promise of online retail. Others, like eToys, burned brightly for a time but faded quickly in the face of the uneconomic (read: way-too-expensive) customer acquisition model that plagued many early Web pioneers.

Together with the e-tail industry at large, we learned lots of hard lessons about building sustainable and valuable e-commerce businesses. That can only be done, in our view, by focusing on the smart development of a consumer brand through profitable customer acquisition and extraordinary customer service. Among today's successes, according to those criteria: Quidsi (operator of Diapers.com and Soap.com), Delivery Agent and Onestop Internet. Moreover, we continue to invest in other types of category-leading companies that play in the e-commerce ecosystem, like Criteo and Convertro, which are becoming indispensable tools to help e-tailers exploit the increasing complex opportunities in online marketing

So now, we offer our own rulebook for this dynamic and rapidly growing sector—Bessemer's Top 10 Laws of E-Commerce.

### **BESSEMER E-COMMERCE RULE #1: You must build a brand, but not through brand advertising**

The ultimate goal for any consumer offering--and the goal that will frame the remaining nine rules--is to build a brand. If your brand becomes synonymous with a particular category (e.g. books for Amazon, DVDs for Netflix) you gain tremendous leverage in your marketing spend. But exactly how you build a brand has changed a lot in the last decade.

Forget sock puppets and pricey Super Bowl ads. So 1999! Brand strength today is built penny by penny (and order by order) with effective direct-response advertising that can be quantified and measured. In some categories your marketing campaign can attract customers for as little as \$10 apiece. *If your offering works* (more on that later), those customers you snag will generate more than \$10 (say, \$30) of profit over their lifetimes. Then, you can reinvest that \$30 in more online marketing. Rinse, lather, repeat. You have a growth (and profit) generation machine.

Once you get big enough that you're spending millions of dollars on direct-response advertising, you can think about more traditional brand advertising. When you can afford it, brand marketing will help you finally convert customers that you probably have touched before with your direct-response advertising but just need an extra nudge. Essentially, if done right, brand marketing becomes yet another form of direct response advertising.

Consider this: [Zappos](#), the online-shoe retailer scooped up by Amazon.com for \$847 million last year, didn't run its first television ad until 2008, even though it was founded in 1999. Clearly CEO Tony Hsieh and his crew knew how to build their company's brand penny by penny. By the time Zappos went on TV, [as many people in the U.S. were searching for Zappos by name on Google's search engine as were searching for Adidas](#), a globally recognized brand.

## Web Search Interest: zappos, adidas

United States, 2004 - present

Categories: [Shopping](#), [Sports](#), [Local](#), [Entertainment](#)

Totals	
zappos	55
adidas	72



Essentially, if you measure your marketing results on a multi-attribution basis (more on this in Rule #6), brand marketing becomes yet another form of direct response advertising. Measure your results. If you are not seeing enough of a lift in your word of mouth or direct “type in” traffic to justify the cost, then you should rethink your brand-advertising strategy.

Another tip: Run lots of marketing experiments of at least \$10,000-20,000 apiece. These might include using different marketing channels like certain comparison-shopping sites that you’ve never worked with, vertical-ad networks or even new advertising techniques like retargeting. Measure the results on a multi-attribution basis and invest in the ones that work well. You may be surprised where the best return-on-investment comes from. Certainly, monitor your ROI and tweak as necessary.

Finally, it’s important to point out that penny-at-a-time advertising doesn’t guarantee you will actually succeed in building a brand. We touch on some of the critical elements of successful brand building in the remaining rules (especially Nos. 4, 5, 8 and 9). While there may not be a clear and concise formula for building a great brand, we’re certain about one thing: It’s virtually impossible to build a brand through excessive marketing. So don’t try it. All of your marketing should be measurable and profitable. If you follow the rest of our ten laws of e-commerce, and steadily increase your marketing expenditures in a profitable way, you’ll lure more and more consumers to your store--and eventually, your brand will emerge. If it doesn’t, you’ve almost certainly been ignoring several of our other rules.

## **BESSEMER E-COMMERCE RULE #2: Customer Lifetime Contribution (CLTC) is your new pulse**

As you build your direct-response marketing campaign, remember to focus on the lifetime value of your customer, or how much profit that customer will generate during the course of your relationship.

The textbook definition of CLTC is the net present value (NPV) of the profit from a customer's purchases. Remember to include all the sales that result from a customer's repeat visits, less any associated costs to service the resulting orders (include variable costs like COGS, credit-card processing fees, shipping, warehouse-order processing, etc). A profitable customer will have a CLTC in excess of its customer acquisition cost (CAC). Treat these profitable customers well.

Once you have a good handle on this metric, you shouldn't be afraid to spend until the marginal CAC (your CAC to acquire the next customer) approaches the CLTC of your next incremental customer, even if it costs more to acquire that new customer than you recoup on his or her first purchase. Note: This *doesn't* mean you should spend until the *average* CAC approaches your CLTC. Rather, you want to spend to acquire customers until your marginal contribution (CLTC – CAC for each new customer) equals zero.

Anything less is under-investing in your business. Obviously, this can be a very scary pill to swallow, so make sure you really understand your CLTC before jumping in.

For early-stage companies, estimating a customer's lifetime value can be more of an art than a science. If you're not fully confident you have a handle on this, instead spend right up to the average, fully-loaded gross profit of a customer's first order. Then you can focus on driving repeat usage.

In the beginning, your average CLTC will be low because you won't have scale. But as you grow, you'll start to see some of the benefits of scale, such as:

- Getting better terms from vendors, because you're buying more (which drives up your gross margins);
- The ability to offer your customers a broader selection of higher-margin, slower-moving SKUs (which increases your average order value, your gross margins, and your customer satisfaction);
- The data to offer better product recommendations (which also increases your average order value and improves conversion rates); etc.

All of these things will increase your CLTC. ***This kicks off a virtuous cycle: CLTC goes up; you can afford to spend more money on marketing; you start to grow faster; you get more scale — and on and on and on.***

It's critical to calculate CLTC as accurately as possible, since it will drive much of your marketing decision making. At scale, follow this rule of thumb: If your CLTC is at least two times the cost of acquiring a new customer, with at least 1X coming in the first 12 months after acquisition, you're in great shape. If you're doing any better than that, it's *irresponsible* for you not to be spending more aggressively on marketing. (And please, call us so we can invest in your company!) If your CLTC/CAC ratio is less than two, then it's worth reigning in your marketing spend until you grow into it.

### **BESSEMER E-COMMERCE RULE #3: The 6 “Cs” are your vital signs: Ignore them at your peril!**

These 6 “Cs” are metrics that provide an unparalleled window into the health of your online retail business.

- **Company Net Promoter Score**, or NPS, is a customer loyalty metric developed by Satmetrix, Bain & Company, and Fred Reichheld. This score is determined by posing a simple question to consumers; it’s a query designed to screen for customer loyalty. Consumers are asked, “On a scale of 0 to 10, how likely is it that you would recommend our company to a friend or colleague?” Consumers offering a rating of 9 or 10 are anointed “promoters”, implying they are likely to promote the company to others. Those who give a rating of 7-8 are “passives”— they probably won’t discuss the company with anyone. Those at the lower end of the scale, with ratings of 0-6, are dubbed “detractors,” since they might speak ill of a company and hurt its prospects with other potential customers.

A company calculates its overall net-promoter score by subtracting its percentage of detractors from its percentage of promoters. So, if 65% of an e-commerce firm’s customers rank as promoters, and 15% as detractors, the firm’s overall NPS would be 50. You should ask *every customer* this simple NPS question after they’ve received their shipment.

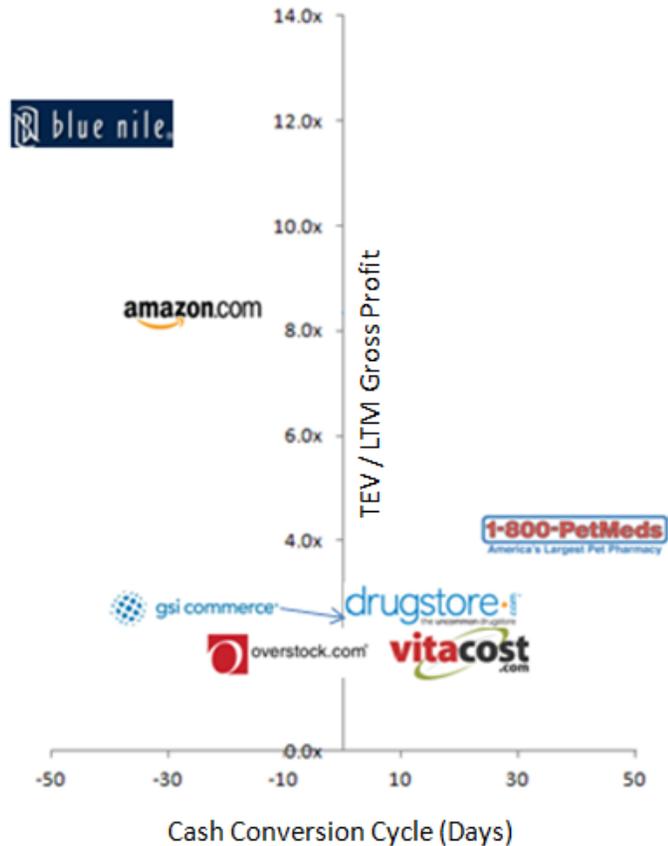
Track and monitor your NPS every month and discuss it in your management and board meetings. Slice and dice the metric to study specific people who have interacted with your customer-service team or who processed a product return. You’ll be surprised by the insights that will jump out. Check out [netpromoter.com](http://netpromoter.com) to compare your score against the best brands on the planet, like Amazon, Apple and Google. Tracking NPS is invaluable.

- **Customer lifetime contribution (CLTC)**. As discussed in Rule #2, CLTC is the net present value (NPV) of the profit from a customer’s purchases. A profitable customer will have a CLTC in excess of its CAC (see next metric). It’s also worthwhile to track the Average Order Value (AOV) on a monthly basis as a leading indicator of CLTC.
- **Customer acquisition cost (CAC)**. This is quite simply your fully-loaded average cost to acquire a new customer. You should track this over time. However, averages can be misleading; not all customers are created equal. You’ll always have one group of customers that come back to your site multiple times and are profitable to you. Others may come once, perhaps pick up some of your lower-margin SKUs—and

never return. Remember: Your goal is to optimize CLTV minus CAC. This means that trying to keep your CAC down is not always your best bet: Sometimes your better customers (those that return and/or buy higher margin SKUs) are a little more expensive to acquire. But they're worth it. If your current average CLTV is at least 2.5X your average CAC, and most of that comes in year one, you've got enormous upside potential.

- **Conversion rate.** For most e-tailers, the relevant conversion rate is the percentage of new visitors that convert to buyers. Here, traditional blocking-and-tackling concepts like streamlined landing pages and fast page-load times are king. If you want to take this metric to the next level, you should think of your conversion rate as a conversion of visitors to revenue producers (not necessarily to buyers)—or, better yet, to gross profit contributors. Essentially, what you are trying to measure is how much money you make from each visit to your website. It's the equivalent of the eRPM (effective revenue per thousand impressions) most Web publishers use to measure their businesses. But here, we suggest eGPV (effective gross profit per visit). Compare the eGPV for all of your visits, and tweak the site paths that are falling below the average. Adding additional revenue streams such as on site advertising may help to optimize this metric.
- **Churn.** Yes, e-commerce businesses have churn too! This is the percentage of your site's customers that never come back to buy anything else. You should also, of course, track the number of monthly visitors who are returning customers.
- **Cash-conversion cycle and return on capital.** Only the simple-minded focus on the P&L statement. No one cares what your profits are if you don't generate any cash flow. Online retail can be tricky because there are lots of ways to burn cash even when you're generating income-statement profits. Inventory and warehouse equipment can consume a lot of cash, particularly during periods of high growth. The best online retailers actually boast a negative cash-conversion cycle. In other words, they get paid by their customers *before* they have to pay their suppliers. Amazon and Blue Nile have negative cash-conversion cycles, so it's perhaps not surprising that these companies have the most attractive valuation metrics in the online retail industry. For example, below, we plotted all the pure-play online retailers, with their cash conversion cycle on the X-axis and their TEV/LTM Gross Profit on the Y-axis. You can see that Blue Nile, with its average -47 day cash conversion cycle for the past four quarters, is valued at a multiple of almost 12X, and Amazon, with its -26 day cash conversion cycle is valued at a little over 8X. Many

leading competitors with much longer, less attractive cash-conversion cycles have valuations hovering around just 3X.



Be aware of this metric, and make smart tradeoffs between vendor-discounts and stretching payables whenever you can. If you want to get really sophisticated, measure cash conversion on a SKU-by-SKU basis.

#### **BESSEMER E-COMMERCE RULE #4: Your goal: cheap, fast and free**

If there is one thing you can count on, it's that consumers will always want lower prices. And once a consumer spends money online, he wants immediate gratification. So for an online retailer, *there's nothing more important than price and availability*. This is the core advantage of scale in eCommerce, but also the linchpin for new sites like Vente-Privée and Gilt Groupe. In our view, that means the best e-commerce companies will offer products at low cost and deliver them quickly—and, often, free of charge.

**Cheap.** It takes just a few clicks for consumers to figure out the market price for any item on the Web. You don't have to offer the cheapest price on all products all of the time. But you should be rock-bottom on those items your customers will use to judge you. Consumers aren't dumb; they generally won't pay more than they have to. Don't forget this.

**Fast.** The biggest disadvantage to shopping online, as opposed to in a brick-and-mortar retailer, is the lack of instant satisfaction. Until the moment of delivery, a consumer has spent his or her hard-earned money but has nothing to show for it—no new Jimmy Choos to wear out on the town, no new leaf blower to show off to the neighbors. Not surprisingly, then, quick delivery is key to delighting customers. A recent survey of U.S. consumers conducted by STELLAService confirmed that the leading factor in determining great customer service was delivery speed:



Companies that care about customer service are laser-focused on fast shipping. For example, our portfolio company Quidsi boasts of reaching [70% of US consumers overnight and the rest in two days](#). To offer your customers the products they want quickly, we believe you need to control the entire customer-fulfillment experience. In the beginning, this may mean using a third-party logistics company (3PL) to own and operate your back end or drop-shippers to fulfill the long tail of SKUs. But once you hit a few million dollars in annualized gross profit, you should keep as many of your SKUs as possible in stock in your own warehouse so you control those products from the moment a consumer clicks “buy” to the moment he or she receives your delivery. Then you can start thinking about fast shipping.

There are two ways to minimize your shipping times. The first is the Amazon approach. If you're like most retailers and lack the gross margins to afford next-day air delivery, build multiple distribution centers across the US, as Amazon has done, and optimize your delivery from each center to each customer. Amazon has 19 distribution centers in the US alone (<http://en.wikipedia.org/wiki/Amazon.com>). You need massive scale to support 19 warehouses,

but even splitting into two DCs – to cover each side of the Mississippi – will improve average ship times considerably. And don't be afraid of regional shippers like [OnTrac](#) or [LoneStar](#). They'll help you reach pockets of the US faster and cheaper than UPS and FedEx. There are also third-party services like [Ensenda](#) and [Enroute](#) to help manage the complexity. Ensenda, for example, links up with 200 carriers in the U.S. alone.

There's also the Zappos approach to shipping. The shoe retailer, with its 45+% gross margins, is able to leverage its rich gross margins and standardized shipping boxes to ship all its products via next-day FedEx air delivery and place its sole distribution center in Kentucky. This is easy and effective, but few retail categories can afford it.

**Free.** Unless you have a unique value proposition or are selling the type of product that costs more to ship than to buy (e.g., bottled water, dog food), consumers now expect free shipping when they shop online. According to a recent comScore survey, 23% of consumers only purchase items with free shipping, and 51% of consumers are at least "somewhat likely" to cancel their order if they don't have a free shipping option. It may even make sense to increase your prices slightly to eliminate shipping charges. We've seen this tactic actually *improve* conversion rates for some e-tailers. Run the numbers, and figure out how you can make free shipping an option for your visitors. Avoid losing your shirt by setting a minimum order size before free shipping kicks in. For one best practices approach, check out Revolve Clothing's [free shipping ladder](#).

#### **BESSEMER E-COMMERCE RULE #5: It's the service, stupid**

Paying Google and other media companies to drive new users to your site is only the first step. To build a brand and a sustainable, profitable business, you want those customers to come back to you again and again – without having to pay for them again and again! To get customers coming back, knock their socks off with an extraordinary customer experience.

This orientation is a commitment that needs to permeate everything you do in your company. [As Jeff Bezos said](#), "**Start with the customer, and work backwards.**" In addition to offering low-cost products and getting them out the door quickly, you should bend over backwards to offer friendly customer service throughout the entire fulfillment process. Train your sales reps as if they're working at the Four Seasons hotel chain. Don't rush customers off the phone. In general, always empower your reps to please customers first and save costs later. At Zappos, for instance, a rep once fielded an eight-hour, customer-service phone call, while another delivered fresh flowers to cheer up a customer. These examples are extreme, but they're the inspirational stories that help define company culture and drive powerful word-of-mouth promotion among consumers. This type of culture needs to be instilled throughout your entire company; every senior executive should spend some time taking customer-service calls.

Another good idea: Creating fabulous surprises for your customers, such as unsolicited coupons, refunds or credits, gifts, or even just patience, apologies and empathy. Across most industries today (think banking, travel, cable TV), the average telephone- or email-based customer-service experience is so bad that it's actually pretty easy to be surprisingly fabulous. Other surprises can be baked into your core offering. Zappos, to praise the company again, has a 365-day return policy with free return shipping. Consumers take full advantage by returning almost 40% of the things they purchase on the site.

You should carefully monitor customer-service metrics such as average wait time (email and phone); abandon rate; average call length; and number of calls needed to resolve an issue. There is a significant increase in abandon rates after 90 seconds of wait time. If you can answer 90% of calls in 120 seconds from when the customer first dials your number, you're well on your way to becoming a best-practices, customer-service organization.

And, finally, while you should always work hard to delight your customers, don't be afraid to fire the perennially annoying ones who waste your time and cost you money. When a consumer calls to complain about a product or claims she never received it, check to see if she's a first-time caller. If so, give her the benefit of the doubt (a full refund, express shipping, etc.). If this isn't the first time, don't be afraid to give her some tough love. Try to understand what marketing channels or products drive these less desired customers and make appropriate adjustments to reduce them or at least make them more profitable.

#### **BESSEMER E-COMMERCE RULE #6: Only lemmings focus on last-click marketing**

Since the advent of online advertising, the conventional wisdom among Web marketers is that the provider of the "last click" that delivers a user to a particular Web site before a purchase "closed the deal", and therefore deserves all of the resulting ROI credit. This methodology has serious shortcomings.

One is that it discounts the classic "marketing funnel." The marketing funnel is a relatively old-school marketing concept but remains very relevant today. It describes the manner in which most consumers go about making purchasing decisions. In the beginning, consumers cast a wide net—just like the wide top of a funnel. They do broad-ranging research and consider a number of products from a number of providers. But then most consumers start to narrow their choices. Their research becomes more targeted, and they look at fewer products as they figure out what they really want. Finally, they're at that narrow bottom of the funnel, having decided on the one product that best suits their needs.

But last-click marketing ignores this critical funnel concept. If a consumer visits, say, a number of Web sites several times over many days (including a few visits to BestBuy.com), weeks or even months before making a purchase—and is exposed to a wide variety of online media

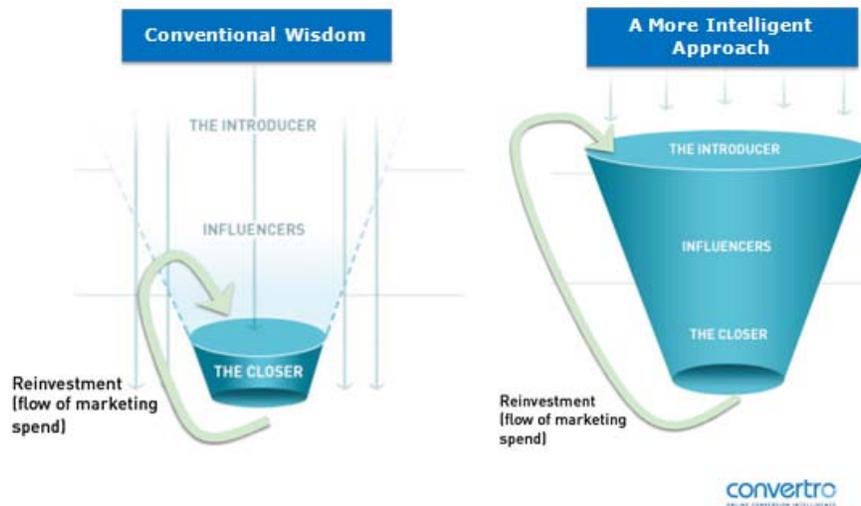
during that time period—why does the keyword he clicked on right before buying a new computer at Bestbuy.com get all the credit for his new laptop purchase? It doesn't make sense.

Another big problem with last-click marketing is that last clicks are often just “navigational”: Consumers use sites like Google and Yahoo as search engines, but also as *navigation* engines. What we mean by “navigation engine” is that a user already knows where he wants to go (to look at a particular printer on the Staples Web site, for instance) but is using a search engine to get there quickly. Consumers have been trained to behave this way because the internal-search capability on most Web sites is quite poor. Consider: A Google search for “Staples HP Laserjet 1200 toner” yields a link to the relevant page on Staples.com as the 6<sup>th</sup> result. But a search for “HP Laserjet 1200 toner” on the Staples.com web site yields 15 incorrect links ahead of the target page. Searching with Google is actually more efficient than searching the retailer's Web site directly. This is important because it means the marketing channel that drove a customer's first visit (e.g., a comparison shopping site) might be more valuable than the channel that drove the last visit (e.g., Google search for “Staples HP Laserjet 1200 toner”).

None of this mattered much until recently. Through 2008, traditional, last-click online marketing had consistently provided a highly attractive ROI with ever-increasing customer volumes. But lately, competition for customers among online marketers has intensified; more marketers are buying online keywords and bidding up their prices. As a result, e-tailers have to spend more money to acquire the same number of customers. What was once a highly attractive ROI has become less compelling. It's time to sharpen your pencil.

It is becoming increasingly clear that attributing “conversion credit” to the last marketing link a user clicks before making a purchase is highly flawed. More often than not, the last-click approach rewards navigational keyword searches. More troubling, it incents online marketers to stop investing in the top-of-the-funnel marketing sources that actually acquired the customer in the first place. Nonetheless, widely used Web-analytics offerings like Adobe SearchCenter (fka Omniture) and Google Analytics are built on the last-click concept. These analytics companies make recommendations about keyword bidding and other online marketing strategies based on that obviously flawed methodology.

A new breed of marketing analytics vendors including Convertro (another BVP portfolio company) is pioneering a much more intelligent approach. These companies adhere to a concept called, fittingly, “multi attribution.” In multi attribution, credit for a purchase is distributed across every marketing event that drove a consumer to a particular Web site, instead of just allocating credit to the last one.



You'll be shocked by how the multi-attribution approach will prompt changes to how you allocate your online marketing dollars. (Hint: most affiliates won't like it, and neither will Google's AdWords team.) We've seen companies use this new approach to suddenly increase their return on ad spend (ROAS) by more than 50%, even though they thought they'd tapped out their online-marketing effectiveness.

Speaking of online marketing allocations, display advertising has played the part of the ignored, ugly sibling of search advertising for far too long. Marketers have often embraced a spray-and-pray approach to display ads and haven't known how to measure their ROI (a cause that wasn't helped by the last-click paradigm). This is changing thanks to retargeting companies like Criteo (in the BVP portfolio). With retargeting, a merchant is able to show a display ad to users who visited the merchant's site but didn't buy anything. Later, when those users are on a third-party site, a retargeting ad promotes the merchant's brand. The hope is that the ad will draw the user back to the merchant's online store. Some retargeting companies, like Criteo, take retargeting one step further. Instead of showing only the company's brand in the display ad, they show the [actual products](#) the consumer browsed (or, even better yet, related products that the consumer may have missed). Retargeting has fast become a must-have tool in any online marketer's toolkit. If you don't retarget your visitors, your competitors will.

### **BESSEMER E-COMMERCE RULE #7: Affiliates are risky. Don't let them pick your pocket.**

Affiliates are third parties that charge a commission when a user clicks through a link on one of their sites to a merchant and subsequently completes a transaction (usually a purchase). On the face of it, affiliates look like a no-brainer—the more of them you can get, the better. But don't be fooled. It's the Wild West out there, and certain evil affiliates are looking to pick your pocket. You are better served having a very tightly controlled affiliate program, and you need to keep a close eye on affiliates for suspicious behavior. Here are three things to watch out for:

Everyone claims credit: As we discussed in Rule #6, consumers often visit a site multiple times before completing a purchase. The larger your affiliate program, the higher the chance that your average customer clicks on the links of more than one affiliate before converting (perhaps they visit the site of a traditional affiliate, and then an online-coupon site). Because affiliates get credit for a conversion even if it occurred several days, or weeks, after the user first clicked through the affiliate's link, this means you might find yourself with multiple parties all claiming credit for the same conversion. A 5% commission for one affiliate is fine. But if you need to pay two or more affiliates the same commission rate, your costs can add up very quickly. To minimize this, you're better off sticking with just one affiliate program (e.g., Commission Junction, Performix, etc).

Watch out for spyware and other scams. The most insidious affiliate ploys are scams like spyware or cookie-stuffing. Ben Edelman of Harvard Business School has a [great report](#) describing how some affiliates use pop-ups, pop-unders, IFRAMEs and other little-known industry mechanisms to trick a user's browser into downloading an affiliate's cookie for multiple merchants—even when the user hasn't clicked on an actual affiliate link. When the user then goes to one of the soon-to-be-defrauded merchants and makes a purchase, the affiliate scammer's cookie claims credit for the conversion.

Other affiliates deploy good old-fashioned spyware. One of our portfolio-company executives recently was combing through his Web logs and noticed that the codes for some of his affiliates were being entered into users' clickstreams milliseconds before transactions were finalized, thereby tricking the merchant into thinking that the affiliate had acquired those customers. The executive soon realized some of his users' computers were infected with spyware. The spyware tracks a user's behavior and, in the first millisecond it sees a shopping cart activated, refreshes the user's browser and slips in the affiliate's code. Our executive notified Commission Junction, the leading affiliate program provider, of the ruse, and the affiliates were quickly terminated. But remember: no one else is looking out for you, so you need to monitor your affiliates yourself.

Don't let them bid against you. Left unchecked, affiliates may bid on your trademark search terms, effectively fighting you for keyword ads and driving up your acquisition costs. Often, affiliates try to take advantage of the navigational-search phenomenon we touched on in Rule #6. If a user types your brand name into Google, he almost always already knows what he wants—he just wants to get there quickly. But if he ends up clicking on an affiliate's link instead of your own, you'll have to pay the affiliate for the conversion even though you did all the hard (and expensive) work to lure in the user in the first place.

## **BESSEMER E-COMMERCE RULE #8: WWAD (What Would Amazon Do)?**

Amazon was among the first online retailers to offer many of the elements so crucial to e-commerce today: affiliate marketing, product reviews, free shipping, a VIP service, on-site

advertising and many others. When Amazon first launched many of these features, observers scratched their heads in confusion (e.g., why would Amazon let consumers say negative things about the products they sell?). But eventually other e-tailers followed suit.

Now, it's tough to find any sophisticated online retailer that *hasn't* implemented product reviews. In fact, companies like BazaarVoice and PowerReviews help online retailers launch product-review functionality with minimal effort. It's now widely understood that product reviews often increase conversion rates by a double-digit percentage.

A newer frontier is onsite advertising. Amazon clearly measures eGPV (see "Conversion Rate" under Rule #3), and every change Amazon embraces improves its eGPV. To this end, Amazon has been running a variety of online ads on its site for a few years now – including Amazon's own pay-per-click advertising and third-party display ads. The thought of letting third-party sites advertise on *your* site, after you've spent so much money and worked so hard to get consumers to visit your site in the first place, might sound sacrilegious. But mark our words: This train has left the station. Onsite advertising represents a great opportunity to leverage manufacturer trade budgets to generate additional revenues for your onsite clicks. While manufacturers usually resist lowering their wholesale prices, they are often willing to provide retailers with kick-backs and promotional budgets, which are equally powerful profit contributors. Companies like Hooklogic and Intent Media hope to be the BazaarVoice of onsite advertising and are already gaining traction with some of the biggest names in e-commerce.

Other Amazon best practices we admire:

- *Metrics-oriented culture.* E-commerce is a low-margin business. To make a low-margin business work, Amazon has an incredibly metrics-oriented culture. Amazon isn't the only one. Time and time again, the most successful e-commerce businesses we see share Amazon's obsession with metrics. (We joke that it's no surprise Quidsi's CEO, Marc Lore, worked in a Wall Street risk-management group before becoming an e-commerce entrepreneur). Take this to heart. A/B test and optimize **everything** - every link, every call to action, every merchandising decision.
- *Obsession with page-load times.* It's easy to be tempted to add JavaScript tags from different vendors to your Web pages to soup up the functionality on your site. But beware: These tags can slow down performance. And Amazon has long known that the faster your page-load time, the higher your conversion rates. In April 2010, Google took the step of incorporating page-load time into Google's all-powerful Quality Score, which makes page-load times more important than ever.
- *Keeping "fit."* Each workgroup in Amazon must build a "fitness function", a customized equation that incorporates the most important metrics for a particular group. When computed, the fitness function creates a single "fitness number." This is the number each group presents to Amazon CEO Jeff Bezos. And if this all-important number isn't going "up and to the right" consistently, the group is in trouble. Each group's fitness

function has to be approved by Bezos, and sometimes it takes months (if not years) for groups to arrive at the right function.

- *Keep it simple.* Amazon has maintained its innovative, startup culture partly by avoiding the temptation to build large teams to tackle big problems. Instead, the company typically takes a problem and divides it into bite-size pieces, assembling small teams to attack each part of the problem. The rule of thumb for the teams is that they should be “no bigger than you can feed with two pizzas.” Most often, this means a team of three developers, a product manager, perhaps a shared designer resource and a manager.

### **BESSEMER E-COMMERCE RULE #9: Identify your best customers, encourage customer loyalty, and motivate the evangelicals**

The rise of social-media services like Facebook and Twitter, and the explosion of niche blogs, means your customers now have very public microphones with which to broadcast their feelings about you. This cuts both ways: Your disgruntled customers have a louder way to complain. But social media also means that your biggest fans (as discussed in Rule #2 and Rule #5) can be heard more, too. They can use social media to sing your praises all over the Internet.

Make sure you take advantage of this phenomenon. The first step is, ***identify your best customers***. They are your most profitable customers, who come back to your site again and again. Work hard to keep them happy. You might try dubbing your most loyal customers VIPs, as Zappos does. This nomenclature may sound silly, but people are naturally proud of being loyal customers of services they like. Then make these customers realize you value them as evangelists or VIPs. Invite them to VIP-only events or sales, and send them special emails to get their feedback. This also serves to ***encourage their customer loyalty***. But you can do more.

Consider Amazon Prime. With Amazon Prime, consumers must pay a fee to participate. But once customers sign up, they get free shipping on all their orders, not just those over a certain amount. This program is incredibly effective at turning *repeat* customers into truly *loyal* customers. The logic is that once you're a paying member of a retail site like Amazon, you'll always consider Amazon first when you want to buy a new book, or a movie or a backpack. You've got to get your money's worth, after all, since you paid an initiation fee to get into Amazon Prime. Amazon's goal with this program is for its site to become a daily habit for its customers. **Mobile apps** serve a similar purpose. If you are able to get a customer to download your mobile app, you make it that much easier for your customers to find you again and use you when the urge strikes.

Yet another gambit is to create a loyalty-points system, as MooseJaw, an online retailer of outdoor gear, has done. This site's program—akin to frequent-flier miles—gives customers ten points for every dollar they spend on regularly priced items, and five points for every dollar

spent on discounted products. Customers can then use their accumulated points to buy products on MooseJaw's [reward site](#).

Now, ***motivate your evangelicals*** to sing your praises. In Rule #3, we discussed the importance of Net Promoter Score. To best leverage your NPS, make it as easy as possible for your Promoters (those that rated your service a 9 or a 10) to promote you. One way is through loyalty or incentive programs. These might be simple offers, like “refer a friend” to save money on a future purchase. But there are a number of new vendors that are emerging that offer other, unique solutions to motivate users to share their purchases. The space is still very young, but it will evolve quickly. The higher your NPS, the better you'll be positioned to leverage it.

### **BESSEMER E-COMMERCE RULE #10: Keep it social, but keep your data too**

Social media isn't just for promoting and evangelizing. Sites like Facebook and Twitter now need to be considered a core part of any e-tailer's sales and marketing strategy. People are spending an increasing amount of time on these sites—a [recent study by Nielsen](#) showed that people now spend 22.7% of their online time on social networks, up from 15.8% just a year ago. Moreover, according to eMarketer, 41% of all U.S. Facebook members connect with fan pages to highlight their favorite brands.

An extremely connected and networked consumer has allowed companies like Groupon to take off, and we expect there will be many new e-commerce models that will emerge to leverage consumers' social graphs. But all e-commerce companies can benefit from social media, if done right.

That means more e-commerce execs are paying attention to “Like” buttons and corporate fan pages, which allow marketers to run promotions tightly integrated into Facebook's feature set and social graph. Brands can also broadcast updates, like coupons and special promotions that appear in users' news feeds. Quick tip: Studies show that Facebook users are more likely to engage with an offer presented on the site if they don't have to leave the Facebook ecosystem to do so. Another best-practice we hear is that Facebook fan pages are most effective when the merchant starts conversations with its followers (e.g., by asking a question) instead of just “pushing” offers out to its fans. If you want to have a best-in-class fan page, check out 3<sup>rd</sup> party products like Involver (BVP portfolio company).

But beware: While it might sound like a great idea to add Facebook Connect integration and Facebook “Like” buttons to your e-commerce site with the hopes of attracting viral traffic from Facebook, proceed with caution. When your customers click that they “Like” a certain product on your site, Facebook records that data and then lets companies target those users with advertising. Essentially, you're giving your competitors data they can use to target *your* customers on Facebook. Depending on what you sell and how competitive the market is, it

might be worth the risk, but tell your employees to let you know if they notice that they are being targeted by ads from your competitors. If you see one of your competitors showing you an attractive offer, you'll know why.

If you're unsure how to best leverage Facebook and Twitter, don't stress about it. Remember: However social-media trends play out, consumers will always, always want three things when they shop online: **lower prices, more selection and better service.**

## CONCLUSION

Your first reaction after reading these ten rules may be, "Yeah, sounds good in a world of endless resources and time!" We understand. In the early days of a young e-commerce business, you can only do so much. But we still encourage you to follow as many of these rules as you can and adopt more of them as you grow. Once you reach \$10m of annualized gross profit, if you're ignoring more than two, we'll bet you won't make it to \$25m.

We hope you benefit from these best practices we've gathered from dozens of talented e-commerce executives with whom we've had the privilege of collaborating over the years. If you have any thoughts, comments or suggestions, please share them with us ([eCommerce@bvp.com](mailto:eCommerce@bvp.com)). We would be delighted to hear from you.

\*\*\*\*\*