

New Key to Success in Online Retail: Geography

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published on BNET.com 10/12/2009



David Bell, associate professor of marketing at University of Pennsylvania's Wharton School.

Plenty of marketers pull mountains of data from the Web, such as search habits and online surveys, to figure out how to reach new customers. The assumption is that many of the retail rules that apply to physical stores don't apply to Internet commerce, or at least not in the same way. **David Bell, an associate professor of marketing** at University of Pennsylvania's Wharton School, says that's not so. In fact, his research shows that any Internet retailer looking for customers would be wise to use some pre-Web methods.

We all understand that people who live in the same community shop at the same physical stores. But you've actually found that people in the same neighborhoods also tend to shop at the same online stores?

Yeah, we call it contagion, or neighborhood effects. We looked at Netgrocer.com and built a statistical model. It turns out that customers of Internet retailers are not scattered randomly on the map. So even when your business is on the Web, you're going to get more new customers in areas that are contiguous to areas where you already have customers.

Why would this happen when people are shopping in private, from their computers?

There are two reasons. One is people may talk to each other. You and I are having lunch and I just happened to buy my groceries on [Netgrocer.com](#) and somehow it comes up in conversation. Or, we live in the same apartment building, you come home at night, the doorman's got a box waiting there that says [Netgrocer.com](#) and somehow that cues you.

So a business could target a specific neighborhood, or zip code, because it wants word to spread in a certain demographic?

Absolutely. Knowing this can help you seed the market and target your marketing. You can take old economy data, like census data, and look at who's living in a neighborhood, for example, or how many stores are there. And it is very informative for how well your Internet store is going to do. ... It also helps to have some buzz-worthy benefit, such as fast and free shipping.

I trust you'd advise companies to combine this data with more direct research?

We worked with [Diapers.com](#) and they asked people to self-identify when they first sign up at the Web site: "Did you hear about us because of word of mouth, search advertising, magazine?" That's really valuable information.

If this social contagion helps online stores, wouldn't it always make sense for Internet stores to target densely populated areas?

Not necessarily. There's the concept of a preference minority. Another Wharton professor, Joel Waldfoegel, wrote a book called, *The Tyranny of the Market: Why You Can't Always Get What You Want*. It starts off with Milton Friedman's line about the best thing about capitalism is that any man can have any tie in any color that he wants.

That sounds like a very appealing statement, but it turns out not to be true if there are high fixed costs to providing stuff. So let's imagine you like red ties and you live in a neighborhood of 100 people but the other 99 people like blue ties. The tie-making guy's going to say, 'Well, screw it, I'm only going to make blue ties, and so you're out of luck.' And so your preference is in some sense hurt by the majority preferences of other people.

So the Internet business can figure out how to try to reach those minorities — the so-called Long Tail customers?

Exactly. Say there are two neighborhoods, both with 100 people that have young kids. In some sense, they both need the same amount of diapers. But if in one neighborhood, most of the people are old, the local stores are going to pay less attention to diapers. What you have is two markets with the same total potential, but the second market, where your customers are more of a preference minority, is the market where you're actually going to get a much higher level of sales.

How do you figure out the preference minorities in what locations?

Well, with diapers it's not that difficult because you can go to the census and you've got this very good information about each neighborhood regarding how many people live there, how many people have kids under four years of age. And so you come up with pretty good proxies for the baby population.

The relevant size of your target population is also a good proxy for how well the local offline competitors are going to treat those people. And an Internet firm can come up with a measure for each location of how many potential customers are there, and how many are majority preference people, and how many are minority preference people. What you learn is that the people who are in the middle of nowhere might be your best customers.

For all the great data that companies are getting from Web activity, it sounds like you've discovered there's a ton of value in offline data.

I think the use of the offline data is really important. The customers for Internet businesses are, of course, in unlimited locations, and this data can help you be much more efficient at targeting. You look at the numbers, but you also have to understand that the way that you acquire customers also varies a lot by location, whether you're getting them from word of mouth or organic search or advertising. So maybe in San Francisco you can get something going by word of mouth, and it's going to be fantastic. But in Philadelphia, it just won't work.

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