Category: Dot-Com Experiences

Dot-Com Conversion at Egghead

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INTRODUCTION

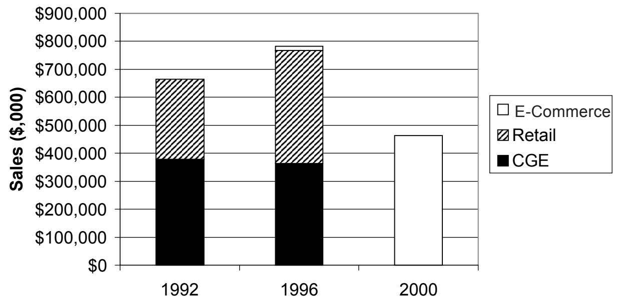
Egghead Software, Inc.'s evolution from a multichannel, traditional retailer of computer software and hardware into an e-commerce-only channel parallels the rise and fall of many e-commerce ventures. At one time, Egghead had a well-defined multichannel strategy, with a direct-sales unit focused on corporate, government, and education customers (CGE); a retail-store unit focused on early adopters of computer software and hardware; and a catalog and call-center unit that targeted consumers and small businesses. Struggling to survive in the face of increased competition and declining margins, Egghead made a series of decisions to sell its CGE unit and abandon its retail stores and catalog operations, shifting all of its resources into an e-commerce strategy. This shift was cited by many journalists and analysts as a sign that e-commerce was here to stay and highlighted Egghead.com as an example that traditional retailers should follow or risk becoming obsolete (Wilde, 1999). This article reviews the history of Egghead, focusing on the decisions and events that led to its demise.

BACKGROUND OF EGGHEAD SOFTWARE, INC.

Victor Alhadeff, a Washington-state entrepreneur, founded Egghead Software, Inc. in the early 1980s initially focusing on providing customers with knowledgeable support, competitive prices, free trials, and a liberal return policy. As one author noted, he aimed to be the high-quality service provider of software sales (Bond, 1996). In the late 1980s, Egghead added a call-center division that targeted customers not able to shop at its retail stores, and a direct-sales division that focused on selling software to corporate, government, and education customers. Its value to many suppliers was in its multichannel strategy (Figure 1), which aligned well with its customer base. It was able to surround customers with numerous points of contact that allowed the customer to buy in the manner they chose. Suppliers could deal with one channel, Egghead, and know they would reach many targeted customers in a variety of different ways.

After a disagreement with the board over the direction of the company, Alhadeff left in 1990. Egghead then went through two CEOs (chief executive officers) with little experience in high technology until Ronald Erickson took over in 1992 (Santucci, Bond, & Golding, 1999). With Erickson in charge, Egghead missed its projected sales and profit forecast. The management team attributed the results to an increase in competition, a slowdown in sales to the aerospace and military markets, and fewer new-product introductions. Egghead's gross margins also declined, causing management to apply more pressure on its retail-store managers with new performance measurements that focused on reducing the cost of returned software. At the same time, the company ran an advertising campaign that highlighted its no-questions-asked return policy (Speck, 1998). As one former store manager noted, the net result was to drive customers away by making the return of software an unpleasant experience (Speck).

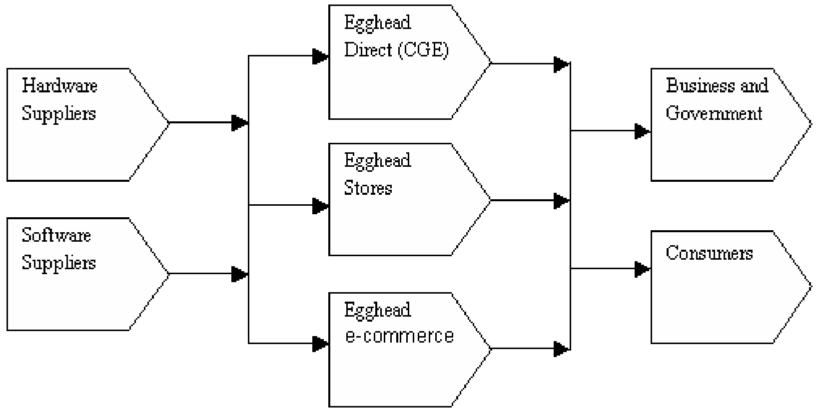
Figure 1. Revenue based on shifting channels (Compiled from Egghead annual reports)



Although margins continued to decline in 1994, Egghead implemented an electronic data-interchange (EDI) system, and signed an agreement with AT&T and Lotus to put its catalog online as part of a test for a new service (AT&T, 1994).

The following year, as sales reached $860 million, Terence Strom, a former vice president of marketing at Best Buy, Inc. was brought in as CEO to help revitalize Egghead's retail-store sales (Browder, 1996). Strom began to develop a new store concept that would average close to 5,000 square feet (twice the size of Egghead's current stores) with more hardware and software (Browder). These new "mini superstores" were designed to leverage Egghead's reputation for excellent customer support while

Figure 2. Egghead's position in the value chain as an intermediary (1983-1997)



also allowing the company to compete with other computer retailers like CompUSA and Best Buy (Browder). In 1995, Egghead had expanded its e-commerce efforts by establishing Elekom, which was charged with developing a new e-commerce system for Egghead (Browder). Egghead's position in the value chain (Figure 2) seemed secure: It would continue to leverage its existing retail locations, updating them to reflect the changing competitive environment, while extending its reach through e-commerce.

Within a year of taking over, Strom then decided that Egghead needed to focus more of its resources on the retail trade. This led to Egghead selling its CGE division to Software Spectrum, Inc. in 1996. The dismantling of Egghead's position in the market had begun.

Around the time that Strom decided to sell the CGE division, George Orban, a minority shareholder and member of the board, began to get more involved in the operations of Egghead. Believing e-commerce was the way to go, Strom, Orban, and their team started shifting efforts into this area. With cash from the sale of the CGE unit, they purchased Surplus Software, one of the early e-commerce developers and owner of the surplusdirect.com and surplusauction.com Web sites. Mixed results from Egghead's mini superstores, coupled with further declines in profitability in the traditional stores, led to the closing of 77 retail locations in 1997. While Egghead still had a strong brand name, a database full of customer information, and good relationships with many suppliers, Orban felt Egghead had to make a move or consider liquidation. Declining revenues and margins in the retail format, triple-digit growth in Egghead's e-commerce channels, and staggering growth projections for e-commerce in general by research firms such as the Yankee Group led Orban to decide the time had come to act. In late 1997, Strom left Egghead and Orban assumed the position of president and CEO.

FUTURE TRENDS: CATCHING THE DOT-COM WAVE

In January of 1998, Egghead announced that it was going to close its last remaining retail stores and focus exclusively on e-commerce through its three Web sites: Egghead.com, surplusauction.com, and surplusdirect.com. "The decision to close our brick-and-mortar retail network was made to enable the company's management and resources to focus on Internet sales and market share," said Orban (McNally, 1998). Many analysts and journalists praised Egghead for transforming its business model, holding it in the same regard as Dell and Gateway. As Erica Regulies of Giga Information Group noted, "This is the beginning of a trend. This is the first time we've really been able to say, 'Electronic commerce is here'" (Miles, 1998). Analysts called Egghead's move bold while recommending the stock as a buy. Orban said that while he also considered closing shop as an option, there were too many strengths and opportunities that led Egghead to the transition. "Egghead had a very strong brand name, great vendor relationships, and a retail culture that would help us take advantage of the Internet opportunity," Orban said. "We had the financial resources to fund the transition, and we put together a management group that was up to the challenge of exiting the traditional business and entering the new business" (Wilde, p. 92).

E-commerce competitors, like Insight.com, thought Egghead had made the right move (Miles, 1998). John Dixon, director of electronic media at Insight at that time, noted, "Retail is going to die. It's on its way out" (Miles). Some analysts were less optimistic. As Katrina Roche, general manager of supply chain solutions at Baan, noted, "it's not acceptable to have only one channel. Consumers expect to be able to buy products through a channel that meets their service needs, some that are oriented toward a higher-priced, high-service level, and some oriented

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