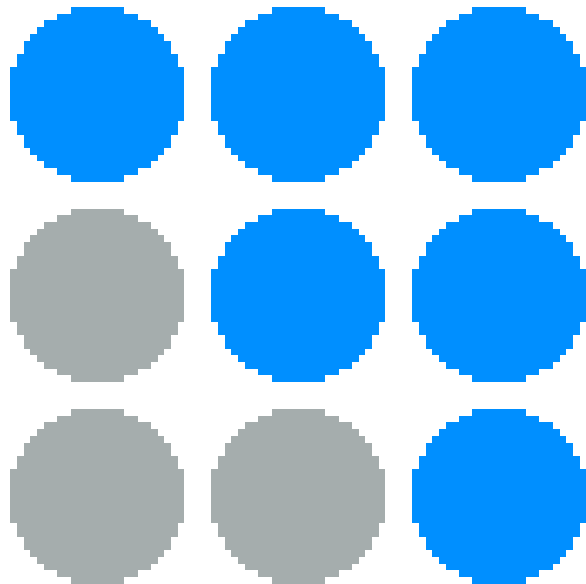


State of the Industry

What Retailers Need to Know About the Future of the Online Photo Market

A White Paper from Tripod Ventures



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Introduction

In the past few years there has been a significant shift in the camera and photo market. For nearly 25 years, growth in this market was relatively flat, with nominal year-over-year movement. However, the explosion in digital camera purchases, the growth of social media and the expansion of a new category of retail - photo merchandise - have significantly changed the landscape, causing many retailers to scramble to keep pace.

Over the last three years, online photo service vendors have experienced strong year-over-year growth and sharp increases in digital print revenues. These changes not only present opportunities, they also present challenges. In 2006, US online photo providers generated just under \$450 million in revenue from prints and photo merchandise. This figure is expected to grow to more than \$1 billion by 2011¹. With this surge in growth also comes a significant increase in the web-to-retail fulfillment model, with orders being placed online and picked-up at retail locations. The continued growth of this model presents opportunities for retailers to create multi-touch relationships with consumers that drive in-store visits and encourage loyalty.

At the same time, the types of products that consumers are ordering are also changing. The online photo market is becoming increasingly aligned with the fashion market, with consumers wanting to control the design of their own items. Photo merchandise, which includes items such as photo greeting cards, photo books and calendars, mugs, and mouse pads, is projected to grow at an annual compound growth rate of 24.5 percent through 2010². This shift toward user designed merchandise means that the tools and technology for placing these orders need to be more sophisticated in terms of features, but in turn, less difficult for consumers to use. Although many retailers have added photo merchandise to their mix of products and services, few have adopted an integrated platform that provides the caliber of user experience to support the new range of items consumers are now ordering.

This paper will explore the challenges retailers face in this rapidly evolving market. It will look at the current state of the industry, rising market trends, and the key challenges retailers face as they adapt to this changing market. It will also address key market opportunities to help retailers choose the best technology for the next few years.

State of the Industry

The year 2007 marked the first year that consumers placed more digital photo orders than conventional film and reprint orders, with most digital orders coming from either in-store kiosks or online applications. Both of these ordering channels present great opportunities for retailers to invite customers into their stores with the possibility of creating additional in-store sales.

From a marketing standpoint, the expertise gained by mass retailers in attracting customers with aggressive film-related products is now being applied to digital photo orders. Retailers are completely committed to digital photo and photo merchandise products.

The major difference between conventional film orders and the current digital photo related orders is the potential for new products. With conventional film orders, consumers were limited to processing and printing, with some added re-prints and enlargement. With digital orders, consumers have more options in how they can apply their images to merchandise. Consumers view the creation of items to be more in line with fashion design than photography and are motivated to create unique items. This has driven the need for more diverse products and services to be introduced to the market.

Regardless of the channel being used by the consumer to place an order, the process is dependant on software. Many of the applications available both online and via kiosk applications present major hurdles for both the consumers trying to use them and the retailers trying to control them. Some of these hurdles include:

High Drop-Off Rates

Retailers today are facing high drop-off rates on consumer transactions. This applies broadly across the full scope of eCommerce transactions, as well as more specifically to the online photo market. For some retailers, drop-off rates are rumored to be north of 50 percent. This is due to a number of factors, from confusing user interfaces, to the length of time it takes to upload photo files prior to starting the order process. Overall trends show an improvement in recent years, but drop-off rates are still one of the most common complaints that retailers cite when asked to list their business challenges.

Who Runs the Business?

Another challenge that many retailers face is having little to no control over their own systems. Even though retailers contract software vendors to customize their technology platforms, the level of control that retailers have is still very limited. In many cases, they can customize the platform to integrate with their website and to take on their look and feel, but that is where the customization ends. Retailers cannot readily make changes to processes, or even set-up special promotions, without involving their software vendor each time. In addition, retailers have little ability to track performance results and to react accordingly. This leaves retailers at the mercy of their vendors for the delivery of key metrics and for any action on these numbers. Very few retailers are able to directly view and manipulate key metrics and to react accordingly.

The Confused Consumer

Consumers are confused, and who can blame them? With the different types of digital photo ordering solutions on the market and the technology that they leverage, consumers are faced with different file selection processes, different editing tools, different ordering templates and even different shopping baskets, depending on the product that they order. This process is completely contrary to the consolidation that's taking place in the eCommerce market. Retailers with a strong focus on eCommerce are doing all they can to streamline their ordering software with easily integrated web tools.

When a consumer chooses to order a large number of photos, he/she will be presented with one type of file selection tool. But when this same customer opts to order a photo t-shirt, the tool provided for choosing one or two images for the t-shirt is completely different. Photo calendars and photo books present even more file selection challenges for the consumer.

Another uphill battle for online consumers is battling the compatibility challenges they face using these software applications with different web browsers and operating systems.

Demand for New Products

The photo merchandise portion of the market is in hyper growth mode. This means that consumer demand for new products is very high. Consumers are looking for new and innovative products that they can customize and purchase. In order to remain competitive, retailers need to be able to quickly respond and make additions to their product mix, without making widespread changes to their order systems or back-end processes. Retailers must also have the ability to add or delete products easily from their photo applications.

Fierce Competition

Competition in this market is blooming in many different ways. There are a number of different types of competitors emerging with different product mixes, from major technology players like Adobe and Apple with online photo applications, to very niche competitors like Scrapblog that promote a new way of sharing photos. This market is experiencing multiple types of competition, from different channels, with different product types.

Need for Creativity Tools

With continuous additions to the types of merchandise available, and the desire for consumers to make their merchandise more fashionable, there is a greater need for consumers to have access to advanced creativity tools for the personalization of their items. This means moving beyond simple photo editing tools to offer more advanced options like soft filters, borders, stylized brushes and etching effects. The key is in balancing functionality with complexity, to deliver the right mix of capabilities without making the technology too difficult for consumers to use.

Lack of Loyalty

Retailers are also impacted by a very price conscious market. Since many consumers now shoot digital photos, they have the ability to be selective about when and how they make prints. Many consumers are fickle and save up their photos to place an order when an attractive price presents

itself. Retailers need to find another way to differentiate themselves beyond price in order to create a sense of loyalty amongst consumers. Retailers that offer a unique user experience and a high level of integration will attract repeat and loyal customers.

In addition, many retailers today are partners with loyalty programs, such as Air Miles, but few software vendors are able to extend these relationships and support them with their photo platforms. As a result, retailers often have to exclude photo purchases from reward point accumulation. However, with the average consumer having five or more memberships for loyalty programs³, offering support for these third-party programs can be a key differentiator in building a loyal customer base.

Lack of Cross-Promos

Even though the connection between online photo and in-store retail is strong, it is nearly impossible today for retailers to run promos that tie-in to the traditional retail sector. One of the key benefits of the web-to-retail model comes with the additional in-store purchases that consumers make when they come to pick-up their photos. Many retailers would like to further enhance this by combining photo purchases with other in-store promotions. For example, if a consumer places an order online for a photo book using a baby-themed template, then the retailer can trigger an in-store promotion for a free package of diapers. This gets customers walking around the store to pick-up their free gift, and encourages them to pick-up more items while they are there.

Back-end Integration and Reliability

With the rapidly increasing number of photo service offers, retailers are often faced with back-end integration and reliability issues.

Some large chains print photo orders on in-store printing equipment, more and more often using digital inkjet and dye sublimation printers. Other orders, such as photo merchandise and photo books are mostly printed off-site, sometimes by several different suppliers. However, all of these orders usually end-up behind the counter of the retailer, to be picked up by the consumer.

With this variety of services it is critical to coordinate so that every printer or supplier receives the same order information, even though they are producing different products. In addition, customer and pricing information must be uniform and clear, so that it does not create customer service issues at the store level.

Market Challenges

Today, there are a number of challenges in the market for consumers, retailers, and software vendors.

Challenges for Consumers

The process of ordering photos, photo books, and other photo merchandise online is not easy for consumers. The technology platforms that exist today are complicated for clients to master and use, and often come with steep learning curves.

Few sites today are designed in a way that consumers can login, choose their photos and place an order that includes multiple items from different categories. The order process is very linear and is based on configuring items one at a time, putting them into the shopping cart, and proceeding to the next one. This can lead to repetition of tasks for consumers, and can create a long and frustrating order process. In addition, consumers must go through the process of uploading a series of large images before they can proceed with choosing and customizing their items. By the time they get to the order process, nearly half of consumers become overwhelmed by the number of decisions they need to take, or frustrated by uploading delays, causing them to abandon their orders.

Consumers can also face technological barriers that prevent them from placing their orders. Most sites today are either very simple, HTML-based solutions that offer clients a poor user experience and limited options, or they're more complex and feature-rich, but require consumers to install software or plug-ins in order to use them. Requiring users to install a specific plug-in or a proprietary application can create a number of security concerns and logistical issues.

Challenges for Retailers

Retailers today also face a number of challenges. From a technology perspective, many of the solutions available today do not fully support their needs. Few solutions offer the right combination of rich front-end interfaces that deliver consumers great user experiences, and back-end tools that allow them to seamlessly manage both administration and marketing functions. In many cases, retailers are still reliant on their software vendors for critical performance metrics, as well as for customizations to their platforms to enable promotions and other marketing activities.

Retailers are also faced with high customization costs when they sign on with a new technology provider. In some cases, it can take up to eight weeks to customize a new platform, and can cost thousands in initial configuration fees. Most of this customization process is still done manually, meaning that changes to processes, workflows or product mix can trigger additional fees in the future.

Once a platform is in place, it is rare that it actually reflects the retailer's workflow. Most retailers have multiple vendors and suppliers in place to meet their product fulfillment needs. However, many technology platforms are not designed to seamlessly support this model of having a common front-end process and the ability to assign orders to different back-end suppliers based on key criteria.

Retailers are also faced with a very competitive market that is rapidly evolving. This means that it's necessary for retailers to be flexible in what they deliver as a product mix, and to ensure that they are able to respond to new demands and trends quickly. It is also important for retailers to be able to track their own performance metrics, and launch promotions when and how they wish.

Retailers also run into issues related to customer service. Many of their in-house teams are not trained to support technical questions, creating frustrated and unsatisfied consumers. This is further complicated by the complexity of the technology they support, as customer service representatives may need to learn multiple processes and systems to help clients.

Retailers are also challenged by the cost of bandwidth. Vendors bill bandwidth in different ways, some as a percentage of the order cost, others as a fixed per-print price. However, the issue that all retailers are experiencing is that consumers today have larger files. In the early days of digital cameras, files sizes were around 500KB per image. Today most cameras produce a file size between 1MB and 3MB. Combined with the fact that print prices are leveling out at a rate close to cost, and it creates a challenging market for retailers to compete in.

Challenges for Software Vendors

Software vendors face different challenges in developing and delivering technology for retailers. Just as the photo market has quickly changed in the past few years, so has the technology market. What's possible today from a technology stand-point is vastly different from what was feasible just a few years ago. This is challenging for software vendors as they must balance technology innovation and advancement with the needs of a demanding industry that operates on a 24 hour-per-day, seven day-a-week schedule.

Consumer expectations are also higher than they've ever been. Consumers want more product selection, more control, faster upload speeds and easier processes, all without having to take any action on their end. Vendors must delicately balance the delivery of rich features with the security limitations presented by consumers' operating systems and firewalls.

Retailers want the freedom to remain competitive in terms of product mix and promotion, and the autonomy to make platform modifications in a more modular way. This means that software vendors need to build tools into their platforms to allow retailers to be more autonomous.

Software vendors are also facing a crunch in relation to bandwidth. The megapixel increase for consumers' cameras means that individual file sizes are larger and the bandwidth consumed in an average order has increased, while the cost of the individual items in the order have decreased. This makes it challenging for vendors, as it's hard to pass along bandwidth increases to the retailers and still remain competitive.

The Future

As we look to the future, there are number of key trends that will guide market growth. Some of these include:

Higher Consumer Expectations

Customers are slowly getting a taste of well designed rich internet applications (RIAs), and now they know what they are missing. They've come to expect superior performance, ease-of-use, and rich customer experiences. There is also a rise in expectations in relation to the features available and to the level of interaction they expect. Many of the applications that consumers are exposed to for other tasks (word processors, video sharing sites, ecommerce sites) are getting rich revamps, making the average consumer expectation higher.

The Experience Economy and Mass-Customization

Since early 2000, there has been a shift in the way the web is used to orchestrate services. Consumers are looking beyond services as a commodity and are instead seeing the interaction as an experience. This has lead to the concept of the "Experience Economy"⁴, a term coined by B. Joseph Pine II and James H. Gilmore in their 1999 book of the same name, and has transformed the processes of ordering goods, like photos, into the experience of creating something unique and special, that triggers a memory or emotion.

Consumers are used to expressing themselves online. They're accustomed to documenting their lives, sharing their thoughts, and personalizing their looks. With the rise in rich eCommerce and the increase in product configurators, consumers are now able to customize many items that they buy, from laptops to sporting goods. They will come to expect the same, or more, from creative products such photo merchandise.

Rise of Storytelling

No longer is the photo industry just about photos. It has evolved into a way to tell a story, trigger a memory or convey an emotion. Consumers are turning to photo books, scrapbooks, and other new products to tell their stories and to create very personalized experiences with their images.

Rise of Design

Good design has spilled over into everything we do, from vacuum cleaners to dish soap. This also applies to photo merchandise. Consumers want to be able to create items that exude their personal style and are viewed more as works of art, than as commodities. Consumers who were satisfied with the ability to crop and rotate their images a few years ago, are now looking for more advanced creativity tools as part of their photo platforms, so that they can create unique and well-designed items.

Continued Growth of the Web-to-Retail Channel

Retail will continue to be a significant channel. eMarketer has named "buy online, pick up in-store" to be one of the top 10 trends for 2008. In 2004, online-to-retail made up just 0.2 percent of all prints ordered, while in June 2007, this figure rose to about 10 percent⁵. This trend will play out to be very important in the photo market as well.

Need for Differentiation

Price stabilization will drive retailers to find new ways to differentiate themselves. Printing volumes will begin to show a slight decline in 2011⁶, making the market more competitive. At the same time, competition is emerging in new forms. Retailers are now competing with more than each other for consumers' business. Competition today comes in many forms, from technology companies like Adobe and Apple, as well as from web start-ups and big-box stores.

What Retailers Need

In this changing market, retailers need to look at their technology strategy for the coming years to see how they can remain competitive. For many retailers this will mean changing their technology platforms for one that will:

Reach the Widest Possible Audience

Retailers need to adopt technology that is able to reach the widest possible audience, both from a hardware and software stand-point, as well as from a cognitive one. This means choosing technology that always works, regardless of the user's computer, operating system, security settings, or plug-ins. It also means solutions that are quick for consumers to digest, and easy for them to follow. Retailers should look for technology that works the way consumers do, with integrated tools, click to buy shopping carts, and support for partially connected situations.

Retailers should look for options that leverage the latest web technology to deliver the richest client experiences with the greatest cross-platform support. They should also consider technology with a service oriented architecture (SOA), as this provides the greatest flexibility for expansion in the future to meet clients' needs for new products.

Improve Client Retention

A key to success in this rapidly changing market lies with the retailer's ability to capture and retain clients. This is three-part effort that starts with providing the best product mix, most interesting promotions, and most competitive pricing to attract new clients. The second part of the formula involves keeping clients engaged and focused through the transaction process by keeping necessary tools and options clear and the shopping process as streamlined as possible. The last element for improving client retention is in rewarding clients for their loyalty. By offering the right mix of reward partners, special promotions and other perks, clients will return to process subsequent orders.

Offer More Control

Retailers need to be able to manage their own businesses. In order to offer the right product mix, at the right price, it's critical for retailers to be able to capture their own performance metrics, view stats on-demand, and develop promotions on-the-fly. This autonomy is a critical component for being competitive in a fast-moving market.

Retailers also need to have control over the products and services that they offer, and the speed in which they are introduced. Once one retailer offers the next trendy item, it becomes a key differentiator and a threat for other retailers in maintaining client loyalty. Retailers must be able to add in new offerings on a regular basis to meet their clients' needs, without incurring high customization costs or long delays.

Provide Better Integration

In the old days, it was all about consolidation and suppliers trying to lock retailers in. However, this is just not the reality of most retailers today. They have different suppliers or vendors in place for different products or different geographic areas. What retailers need instead is a single platform that delivers one common customer experience, yet seamlessly supports their needs to manage multiple vendors.

In addition, retailers need to have solutions that integrate perfectly with their technology environment and business processes, including their websites.

Streamline Processes and Improve Speed

In order to minimize drop-off with consumer transactions, retailers need to adopt platforms that streamline the product customization process, accelerate the ordering process and improve the total speed of the transaction. Solutions that minimize the quantity of data to be uploaded and that move the upload process closer to the end of the transaction will help improve the overall customer experience. Retailers need to look at solutions that offer these process improvements in order to attract and lock-in customers.

Offer the Lowest Entry Fees and Customization Costs

Retailers need to be able to respond quickly to new market needs and to have options in doing so. This means that getting started with a new technology platform should not mean high barriers to entry or large customization bills. Platforms need to be agile, modular, quick-to-deploy and easy-to-customize. Retailers must be able to make a choice to move forward, and be up-and-running in a matter of hours or days, not weeks. They must also have the flexibility to add and modify the platform on an ongoing basis. The shift toward web platforms that operate using a Software as a Service (SaaS) model are a compelling way for retailers to get started quickly, and deploy improvements and customizations on an ongoing basis.

Deliver the Right Mix of Technology

The key for retailers is in striking the right balance between reliability and innovation. Consumers want their technology to work, and work well, all of the time. However, they also want vast improvements in the experience they have while using this technology. With any form of mass innovation, there are always risks. Therefore, retailers should look for technology platforms that deliver innovation, but with a solid foundation of proven technology at the core.

Conclusion

In order to remain competitive in the industry, retailers need to act now and plan for their future. They need to critically look at the technology that they have in place, and gauge the experience that they are providing to their consumers and to their employees.

Retailers need to ensure that the solutions they choose for the coming years deliver the flexibility, automation, speed, and customization potential that they will need to remain competitive in this changing market. At the same time, they will want to ensure that they have access to the critical metrics and data that they will need to gauge their success, and to adapt on-the-fly as needed.

Retailers also need to look at how their web presence stacks up against increasing consumer expectations and what key differentiators they offer. Price will no longer be enough of a differentiator as retailers fight for their piece of the pie.

The retailers that will survive, and ultimately thrive, will be the ones that embrace technology changes and improve their overall customer experience now before competition heats up even more.

About Tripod Ventures

Tripod Ventures Inc. was formed in 2007 to meet an emerging need in the retail sector for Web 2.0 technology solutions that combine stellar user experiences with operational excellence. Each of the company's three founders brings a different cluster of expertise to the group: technology innovation, operational excellence, and a deep strategic knowledge of the retail business. The company is dedicated to funding the development and operation of unique technology solutions for the retail sector that enable retailers to manage the order and fulfillment process for user generated objects. The privately held company is headquartered in Montreal, Canada. For more information about the company, visit its web site at www.tripodventures.com.

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