UNIVERSITY OF PRIMORSKA
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BACHELOR THESIS

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E-COMMERCE AND ITS IMPACT IN THE FASHION INDUSTRY

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SUMMARY

The thesis is focused on exploring the evolution of e-commerce and its role in the fashion industry. The focus is set on the influence e-commerce has on pricing strategies and customer returns as important factors of profitability. Despite increased interest in the topic, there are very few studies that have published results on the main drivers and the influence of e-commerce in the fashion industry. Through qualitative research and using content analysis, we have uncovered that increased competition within the industry has led to mass adoption of dynamic pricing and personalization to combat high returns.

Keywords: e-commerce, impact, fashion industry, pricing strategy, returns, e-loyalty.

POVZETEK

Teza je osredotočena na raziskovanje razvoja e-trgovine in vlogo v modni industriji. Poudarek je na vplivu e-trgovine na strategije cen in donosnosti kupcev kot pomembnih dejavnikov donosnosti. Kljub povečanemu zanimanju za temo je zelo malo raziskav, ki so objavile rezultate o glavnih dejavnikov in vplivu e-trgovine v modni industriji. S kvalitativnimi raziskavami in uporabo vsebinske analize smo odkrili, da je povečana konkurenca privedla do množičnega sprejemanja dinamičnih cen in personalizacije za boj proti visokim donosom.

Ključne besede: e-trgovina, vpliv, modna industrija, cenovna strategija, donosi, e-zvestoba.

UDC: 399.138:687.5.01

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ABBREVIATIONS

B2C	Business-to-customers
B2B	Business-to-business
FM	Faculty of Management
IPO	Initial Public Offering
ROI	Return on investment

1 INTRODUCTION

This chapter includes a brief introduction into the subject of the thesis. Next, it specifies the research problem, research questions together with the main purpose and aims of the thesis. Furthermore, it contains specific assumptions and limitations that are relevant to the study.

1.1 Background

The development of the Internet and digital marketplaces have caused tremendous change on the economy and have changed the traditional ways of the economic theory. Through such changes, the distance between the trading counterparties has shrunk significantly. Data transfers are becoming more and more common as a medium of information change and have significantly defined business principles in e-commerce. E-commerce has been changing the world as we know it in the past couple of decades. Its tremendous role in e-retail has been projected to create sales of 6.5 trillion dollars for the year of 2022 (Statista 2020). For reference, the USA has recorded an increase of 14.9% in e-commerce sales in 2019 with customers spending more than 600 billion dollars online (United States Census Bureau 2020). In Germany, every third shopper orders products online multiple times a week. Also, every third order is placed using a smartphone or a tablet, in contrast to five years ago when the mobile share was only 20% (Bundesverbahn und Versandhandel 2020). Global e-commerce revenues continue to surge despite slow economic growth and projected to grow at double digit rates over the next five years, remaining the fastest growing form of commerce (Laudon and Traver 2017). One of the leading industries in e-commerce has been the fashion industry. According to a study conducted by Grant Thornton (2018), over the next decade, the fashion and apparel industry is expected to reach significant sales growth mainly driven by an expansion in the global market. Experts predict that the e-commerce segment of fashion and apparel will increase at a compound annual rate of 10.6% from $481 billion in 2017 to more than $713 billion by 2022. Apparel companies have relied on several factors in order to stay profitable on the long-term. One such factor is loyalty of the buyers which is a key factor for growing presence and profitability (Eid 2011). When it comes to the lifetime value for online customers, according to Anderson and Srinivasan (2003), a loyal customer is worth 10 times more than a regular customer. Customer loyalty has become even more important in the online space as competitors are just “mouse click away” (Anderson and Srinivasan 2003). Thus, the interest in creating loyalty has made companies more curious in finding out which factors have a key role in defining loyalty among customers. Additionally, transparency has increased dramatically in recent years and comparisons between different alternatives is much easier than ever before. Consequently, customers are very informed, and this creates pressure on companies to stay on top of their game in acquiring and retaining customers. Return policies have thus become a key factor when deciding whether to purchase an item online. Today, 20% of all returns account for e-commerce returns. Of that, 43% refer to clothes returns. Especially after the current pandemic, the world is about to see a major turnaround in the shopping experience. Governments have put in place measures to increase network capacity, encourage the provision of expanded data at low cost and lowered the transaction costs on digital payments. As a result, sales in B2C and e-commerce in B2B have spiked. On the other hand, the crisis has adversely impacted trade causing a disruption in overall supply and demand. Such disruptions have led in delivery delays and cancellation of orders. Other challenges that have arisen or amplified during the pandemic include price gouging (unreasonable price increases), concerns in product safety, cybersecurity etc. (World Trade Organization 2020). Therefore, it is of utmost importance for online fashion retailers to have a flexible pricing strategy and return policies to adjust to the changing environment. In this thesis, the focus is set on understanding the evolution of e-commerce and its impact on pricing strategies and customer returns in the fashion industry.

1.2 Research problem discussion

This thesis will be mainly focusing on the evolution of e-commerce and its impact in the fashion industry. Namely, it will focus on the impacts of pricing strategies that fashion retailers undertake in order to be competitive, as well as the impact that e-commerce has on customer returns and loyalty.

The rapid development of technology has created a lot of pressure on businesses. Therefore, it has become increasingly important to be at the forefront in managing company policies and introducing incentives that will help attract and retain customer. One such policy that many fashion e-commerce companies have used to retain customers is the return policy. Companies compete through offering different advantages: return price and return time. Therefore, it is very important to understand how the development of e-commerce has affected such policies for companies in the fashion industry and what the implications to the businesses and customer loyalty are.

In addition, due to the increased transparency, customers have a very high purchasing power, making it very easy to switch to another brand. Thus, companies need to find other ways to retain customers as well, such as developing and adjusting different pricing strategies. In this thesis, this important factor will also be analyzed to see how e-commerce fashion companies have adapted pricing strategies to the market.

The significance of the topic “E-commerce and its impact on the fashion industry” was chosen as a subject of interest for a couple of reasons. Firstly, the fashion industry in e-commerce was chosen as a topic of interest since fashion e-commerce is currently the most prominent segment of the global e-commerce market. Purchases of clothing and other forms of apparel have been exceeding all predictions year-on-year and therefore having an overview of the abovementioned impacts can be beneficial for future research. Secondly, the focus is on specific effects such as pricing strategies and customer returns since these are critical factors that affect the ROI of companies operating in the e-commerce sector. Especially in the fashion retail industry where transparency is very high and customers can easily compare prices and return policies, having a good overview of the effects of e-commerce on these factors can significantly help companies and researchers. Finally, there have been many studies analyzing the influence of different factors of e-commerce and have developed theoretical frameworks and critical elements for future analysis. In addition, the fast development of the interned requires continuous re-evaluation of other studies and building up further findings on the current research. Therefore, conducting a study that is up to date to the concepts and the development of e-commerce within the fashion industry can be beneficial to future research.

1.3 Purpose and aim of the thesis

The main purpose of the thesis is to analyze the impact of e-commerce on pricing strategies and returns due to the dynamic nature of the topic and the need of continuous evaluation of previous findings.

The main aims of the research are connected to understanding the evolution, the impact and the future of e-commerce in the fashion industry worldwide. The main aims include:

- analysis of the evolution of e-commerce and its factors,
- understanding the impact of e-commerce on key factors for success in the fashion industry,
- developing key findings that are relevant for e-commerce companies operating in the fashion industry.

A theoretical framework will be analyzed in order to clarify concepts studied in the thesis. It will serve as a foundation for analysis of the empirical data collection. It will include concepts that are central and relevant in the ongoing development of e-commerce and the fashion industry.

In order to analyze the research questions secondary sources of data will be analyzed. Data will be used from marketing course literature such as journals, publications, articles and statistical offices. Case studies from specific companies will also be presented in order to draw conclusions. Since the data that will be analyzed is of qualitative nature, content analysis will be used as a research method.

1.4 Research questions

From the abovementioned problem discussion and the aims, the following questions have been analyzed:

- How has the role of e-commerce evolved in the fashion industry?
- How has e-commerce impacted pricing strategies in the fashion industry?

- How have customer returns evolved in e-commerce and what is their impact on customer loyalty?

The answers of the research questions, will provide an answer to the main research question: What is the impact of ecommerce in the fashion industry from a pricing and customer returns perspective?

1.5 Assumptions and limitations

Assumptions included in the thesis were related to the scope and the analysis performed. Firstly, it was assumed that the scope of e-commerce will continue to increase at the same rate as today. Secondly, it is assumed that the analysis and findings are relevant only for companies in the online fashion industry. There were also several limitations when conducting the study. Firstly, the literature used to understand e-commerce is vast and some data is hard to access. Although a significant amount of literature was used to analyze the subject, there are further studies and articles connected to the topic that could have additionally been analyzed. Secondly, the research is focused only on the impact of e-commerce on the fashion industry, therefore the findings refer only to this specific industry. Finally, the research is not country specific, thus differences in the findings may emerge if the analysis is performed on a country level.

2 THEORETICAL BACKGROUND

In this chapter, the theoretical background is presented. It serves as a foundation for analysis of the empirical framework. It consists of concepts that are central and relevant in the ongoing development of e-commerce and the fashion retail industry.

2.1 Introduction

As the innovation in internet technologies advanced, mainly with the development of the Internet, a new form of commerce was introduced. Since the beginning of the 90s, the electronic commerce has continuously shaped and reshaped many industries. According to Chong (2008), with the development of e-commerce the way of conducting business has changed forever. E-commerce is continuously reshaping the economy and businesses and thus its importance has been increasing every year since the very beginning. Today, it has become a powerful tool for companies to stay competitive on the market by increasing sales and revenues. Before starting to explore the impact and evolution of e-commerce, a clarification of the term will be provided as well as a clarification of the concept within the fashion industry.

2.2 The concept of e-commerce

In the following chapters, a closer look is provided on the definition of e-commerce as well as an overview of the current state of e-commerce in general. The purpose is to get a broad understanding on the topic of interest.

2.2.1 Definition of e-commerce

There have been many publications in the past years that have given different definitions and concepts about e-commerce. In the beginning, the definitions were quite simple and electronic commerce was defined as buying and selling by using online technology. This concept was later built upon and the following phrase was added "buying and selling goods as well as exchange of information" (Chong 2008).

Later, e-commerce was defined as "the process of buying, selling, transferring or exchanging of products or services and/or information via computer networks such as the Internet" (Rainer et al. 2011). In other words, this process supposed flow of information both before and after the purchasing process. This definition was also adopted by Rayport and Jaworski (2002) who added that the exchange process is mediated through technology on inter and intra organizational activities.

To summarize the definitions mentioned above, e-commerce is not limited so selling and buying, but on a much broader concept. Therefore, for the purpose of this thesis, a summarized definition for e-commerce will be used: "E-commerce is the process of integration of company processes and activities to buy and sell products or services, or exchange information and funds through computer networks and electronic technologies".

2.2.2 Introduction to e-commerce

E-commerce is continuously changing the way companies do business and has created transparency that helped customers compare products across channels, which in turn increased their purchasing power. For a customer, e-commerce provides convenience of shopping, large variety of products and services, it is less costly, more time saving and offers anonymity of the buyer. From a company perspective, e-commerce offers the possibility to service customers and provide tailor-made solutions for individual customers. Unlike brick-and-mortar stores, e-commerce enables businesses to easily reach new customers and quickly expand to new business areas. Therefore, with the ability to do business online, companies can reach new potential markets and expand their customer reach.

Since the very beginning of the electronic commerce, online purchasing has noted a massive growth. According to recent studies done by Statista, the e-commerce market is expected to grow up to 6,5 trillion US dollars by 2023.

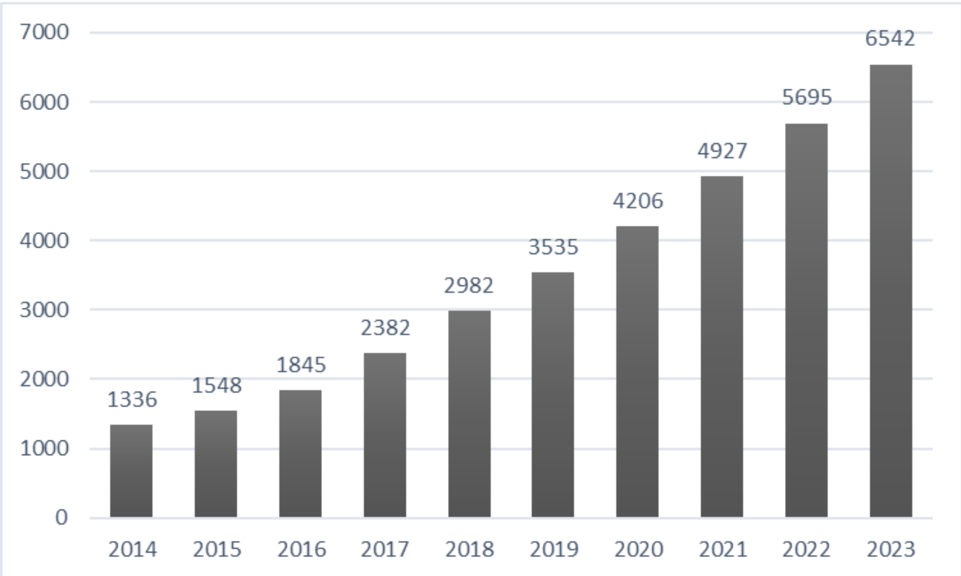

Figure 1: E-commerce growth from 2014 to 2023 in billion of US dollars

Source: Statista 2020.

E-commerce has also enabled the growth of retail sales as well as encouraged the retail market to adapt and modernize its practices. The unprecedented growth expected is also present in terms of the share of e-commerce in total global retail sales.

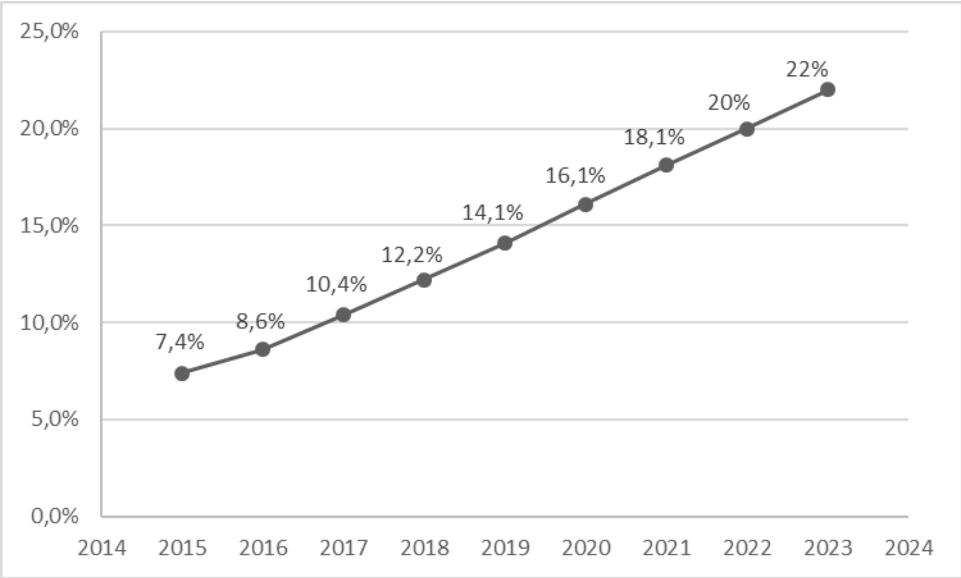

Figure 2: E-commerce share of total global retail sales from 2015 to 2023

Source: Statista 2020.

We can note from the figures above that as Internet penetration and accessibility increases, more people will benefit from the online services. The e-commerce sector is expected to reach double-digit growth in all countries around the world. The highest market growth is expected in the Asia-Pacific and Latin American regions. In addition, as digital payment options have become widespread in these regions, e-commerce is expected to thrive immensely.

The emergence of e-commerce and the new economics of the online world have made it very difficult for retailers to earn a profit. Price elasticity has increased, and margins have plummeted due to greater competition, while on the other hand, e-commerce requires smaller investments and usually has lower fixed costs than traditional retailers. However, the main difference is that e-commerce operators have low expectations for the financial performance: they are valued based on profits they might achieve in the future, not the profits they are making today. On top of this, some e-commerce owners run their business operations entirely as a loss leader in the hopes of buying a customer base that might turn profitable years down the road. In such winner-takes-all markets, competitors that expect low earnings depress the profitability of the entire sector (Oliver Wyman 2015).

In the following chapters, we will look closer into the fashion industry and its global growth and clarify the concepts of returns and pricing.

2.3 The online fashion industry

The online fashion segment was defined by Statista as the part of e-commerce that includes the online selling and purchasing of apparel for all genders, including shoes, accessories and other types of fashion items. The apparel segment is considered to be the largest segment in e-commerce, constituting 65 percent of all e-commerce sales. Another characteristic that is attached to the fashion industry is the time to market, which refers to the ability for the fashion retailer to produce new and fashionable trendy items and provide them to the customers in a timely manner. This is often called “fast fashion”, where retailers center around quickly furnishing buyers with affordable fashion. The development of fast fashion was initiated mostly due to customer demand that the speed increases in every process including a faster shopping experience. Customers have become very demanding of online retailers and expect that their wishes are satisfied straight away. Such behavior has led to many companies attempting to offer 90-minute deliveries on orders, which naturally brings many difficulties in the supply chain (Friedman 2017). According to Cohen (2011), the ability to quickly provide products to the market includes streamlining the entire value chain. Therefore, such systems, requires flexibility of the supply chain to be profitable and successful in the fashion industry.

Currently, the online fashion commerce is valued at $581 billion dollars in 2019 (Statista 2020). With the advancement of technology and the increased internet penetration, the market is expected to grow for 35% to $765 billion in 2022. Other explanations for the growth are that the middle class has been expanding around the globe, providing an opportunity to spend a larger part of customers’ income for non-necessities like apparel.

Regardless of the positive developments, businesses are confronting difficulties in the up and coming years. One of the more troublesome challenges is connected to ecological sustainability. As an ever-increasing number of individuals are mentioning sustainability as a key for making a purchasing decision, requirements for sustainability are seen on many aspects of the business including the item production and shipping arrangements. In addition, the high return rates within the industry, which can reach or exceed 50% of the total sales, are major causes of concern. If this pattern continues to grow at that rate, online brands will need to find new ways to protect their margins (Orendorff 2018; Statista 2020).

The term fashion should also not be confused with style which can exist outside of the fashion industry. These days shoppers can peruse various styles, for example, in the web, yet what is popular relies upon the customer's own disposition and discernment. According to Shaw et al. (2009), individuals use fashion as a way of expressing oneself and showing off one's status in the society. Despite its broad definition, fashion in this study will be referred to clothing since this is the main product category for online fashion retailers.

2.4 Segmentation of online fashion retailers

The fashion industry can be segmented according to price, value and quality of offerings. (Bruce and Daly 2006). The most common way of segmentation of the fashion market is by using the price segmentation (Bandinelli et al. 2013). According to this segmentation, there are five different segments which can be seen on the figure below (Figure 3).

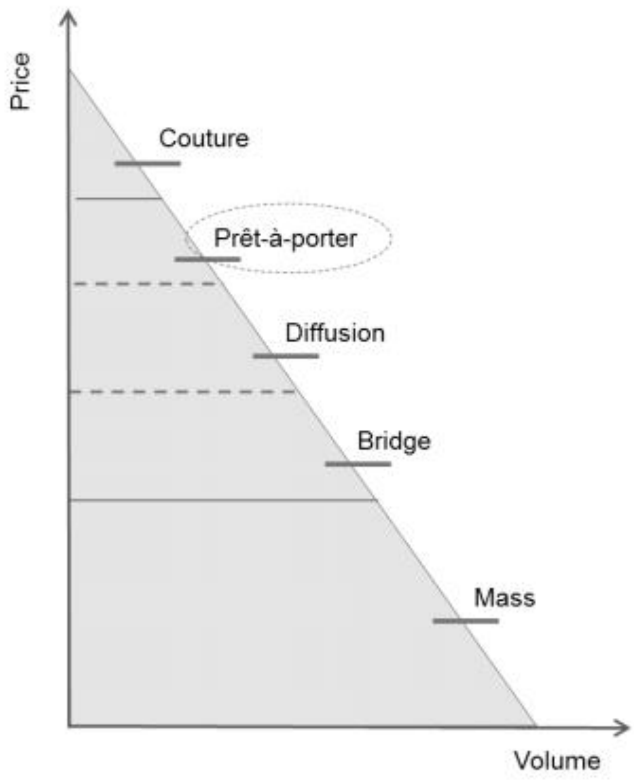

Figure 3: Segmentation ladder of the fashion market

Source: Bandinelli et al. 2013.

In the *couture* segment, luxury global brands are included, and this segment closely relates to product exclusivity. The word couture comes from the French word which means high dressmaking or high fashion. These worldwide design houses have a solid brand character which depends on brand esteems and pictures that have a worldwide and all-inclusive intrigue (Moore et al. 1997). However, the market is very tiny, as the prices are very high. That is why many couture brands need to offer bridge brands swell in order to achieve higher sales, since very few customers can afford couture. In order to qualify as an official Haute Couture house, brands must be able to design made-to-order clothes offered to private clients, including more than one fitting, and have an atelier that employs at least fifteen full-time staff. Couture brands must present a collection of more than fifty original designs every season.

Prêt-à-porter, in literal terms translates to ready-to-wear products. The products are most of the time expensive, but still not as expensive and exclusive as couture clothing. The items are high quality and are factory made. Although many confuse the two, prêt-à-porter differs from couture mainly that the former is more available to a wider public (Rantisi 2009). Such collections are often available preseasonally and are not made to order. In contrast to couture brands, ready-to-wear brands are produced faster and in larger quantities. Although they take inspiration from couture brands, these collections do not have the level of exclusivity that a couture brand has.

Diffusion is the third segment which includes the same criteria as the segment above, with the exception that it includes industrial brands, not luxury (Bandinelli et al. 2013). The borders of this segment are still unclear as it touches upon two other segments: prêt-à-porter and bridge. Although it is closely related to prêt-à-porter, diffusion brands are mostly affordable versions of a luxury brand and target a wider market. Since the product prices are affordable, there is a higher demand from customers for diffusion lines. For instance, Calvin Klein has launched a diffusion, secondary brand, called CK Jeans which is less pricey than the main brand. A diffusion line is defined according to the Oxford Dictionary (2014) as follows: range of inexpensive ready-to-wear garments that are produced for the mass market by a fashion designer. In other words, diffusion makes inaccessible luxury brands more accessible for customers that want to wear an expensive brand but cannot afford a designer label.

Bridge is the link between two segments, diffusion and mass. It is a new category that launched recently, and it refers to a niche brand with accessible luxury fashion. For example, Michael Kors is considered a bridge brand, as it has a price point between high-fashion brands like Prada or Chanel and mass market brands. Finally, the segment on the bottom of the fashion ladder called *mass*, refers to affordable, low priced brands that are not customized. Mass brands produce clothing in large volumes and can quickly adopt new fashion trends. The entrance of such fast fashion players has increased the competitiveness of the segment and has enabled buyers to purchase affordable but trendy clothing items (Bruce and Daly 2006).

2.5 Returns management

Returns management, according to Rogers et al. (2002) can consist of many areas within the supply chain of a company. For example, returns and warehousing, storage and inventory or disposal of the goods. As discussed previously, with the development of e-commerce, returns have become prevalent in every industry. However, in the fashion industry returns have been a significant problem for online retailers, and researchers have continuously stressed that companies need to focus on managing the return processes. A fundamental reason for poorly addressing the returns issue has been the lack of experience in managing returns and this has led to poor management and inadequate return procedures in many cases (Winkler 2018). In addition, Lummus, Vokurka and Krumwiede (2008) and Mentzer et al. (2001) have also stressed that maximization of the supply chain can be accomplished by focusing on the processes that have a vital role in the return process.

According to Röllecke, Huchzermeier and Schröder (2018) there are three main types of returns management programs. The first type relies on a cost view where the company's key goal is to reduce the effect that return costs have on the profitability. This type does not consider customer satisfaction when the purchase is made. An example of such policies can include not offering free returns and having a cumbersome return process, and making it difficult for the customer to return the item. In addition, some companies may even refuse the return if no receipt is shown or let customers be in charge of the entire return process. Such policies are usually used by small companies that are unable to differentiate serial returners from loyal customers.

The second type of returns management reflects the need to balance between costly returns and managing customer satisfaction and loyalty. Retailers enforcing these programs for the most part attempt to leverage client information so as to give more advantages to loyal customers, while acquainting a series of measures to reduce serial returners. A model that relies on this strategy is Amazon, which give free returns on account of profits activated by some Amazon mistake yet charge a transportation expense and refund deduction otherwise. In addition, they have closed many accounts of customers who repeatedly return items. This type of return management is usually used in industries that have lower margins, but where customers satisfaction is still an important consideration due to high competition in the market.

The third type is entirely centered around improving consumer loyalty. Companies using this program rely on the hypothesis that the advantages of using the strategy outweigh all expenses related to returns. This strategy is commonly used by online fashion retailers, since most customers have the need to experience the product physically before settling on whether they actually want to purchase it. In addition, customers anticipate a similar experience to that in traditional fitting rooms, without inconveniences and for free. Röllecke, Huchzermeier and Schröder (2018) give Zalando as an example of an organization executing a strategy where the key objective is to keep customers satisfied.

2.6 Loyalty in e-commerce

Although this thesis will only briefly touch upon the topic of loyalty in online fashion industry, it is important to have a good theoretical base on the matter. Therefore, the topic of e-loyalty and trust will be explored in the next sub-sections.

2.6.1 E-loyalty

According to Reichheld and Schefter (2000), building a superior loyalty is no longer the only way of achieving high profits, but today customer loyalty is essential in order to survive in the competitive landscape of the industry. Loyalty is crucial for profitability of the business since loyal customers are considered of higher value than regular customers (Anderson and Srinivasan 2003). However, some researchers like Kin and Choobineh (1998) stress that loyalty is an issue when it comes to online retailing. In fact, with the development of technology as more businesses enter the electronic commerce market, e-loyalty becomes increasingly important. Since competitors in online commerce are only a few mouse clicks away, businesses need to be able to attract and retain loyal customers. It is also possible that loyalty in electronic commerce is even more important than loyalty in bricks-and-mortar retailing. Reichheld and Schefter (2000) stressed that in order to achieve loyalty, businesses need to offer a hassle-free experience for the customers. Customer loyalty has been defined as the chance of a customer returning and providing positive publicity for the business (Islam, Khadem and Sayem 2012). In addition, e-loyalty also refers to the intention of the customer to repurchase from that brand in the future. Therefore, an updated definition would include: *"the customer's favorable attitude toward an electronic business, resulting in repeat purchasing" (*Anderson and Srinivasan 2003). E-loyalty influences profitability positively as a result of the long-term relationship with the customers and lower costs associated to the acquisition of additional customers (Kim, Jin and Swinney 2009). The more positively a customer experiences an online brand, the more likely they will be to purchase from that same brand again. In addition, the positive experience will likely lead to the spread of positive word of mouth. (Islam, Khadem and Sayem 2012). In order to understand the ways to increase loyalty in e-commerce, there are other factors that need to be considered: e-trust and e-quality.

2.6.2 E-trust

According to multiple researchers, trust is considered to have a vital role in building and driving e-loyalty (Ribbink et al. 2004). In order to achieve customer loyalty, companies need to first gain their trust (Reichheld and Schefter 2000). Trust is also an important factor for building strong relationship between the company and its customers, but at the same time trust is also considered difficult to manage. Trust in e-commerce sense is defined as "a *belief in the system characteristics, specifically belief in the competence, dependability and security of the system, under conditions of risk"* (Kim, Jin and Swinney 2009). Trust in e-commerce is very important since there is little guarantee that in an online environment the e-commerce brand will withhold from undesired and unethical behaviors, like unfair pricing, inaccurate information or disruption of personal data (Gefen 2012). Thus, due to such risks, customers who do not trust the brand will be less willing to purchase from that brand and more inclined to returns. Hence, gaining trust is of utmost importance in e-commerce, where the perceived risks are higher compared to in-store shopping (Reichheld and Schefter 2000). Many perceive doing business online as risky, since the customer is unable to interact with the company or its employees, or even test the product they are about the purchase. Thereby, trust becomes key for the online brand since a consumer purchasing online could be required to share sensitive data like credit card details or personal information. In order for a customer to obtain trust, the security risks as well as the privacy concerns are critical factors. These elements are also important for the overall online experience and shopping.

2.6.3 E-quality

In order to be successful in a competitive market, companies need to deliver superb service quality. According to Chiu et al. (2009), this is also important online for e-commerce brands to be successful and have satisfied customers. It is essential for an online retailer to pay attention to product quality and win loyal customers. Perceiving service quality positively affects consumers' willingness to purchase and their satisfaction. Zeithaml, Parasuraman and Malhotra (2001) have stressed that customers evaluate the quality prior, throughout and after the shopping took place. Online shopping can be divided into multiple stages depending on how the customers perform purchases (Lee and Lin 2005). For example, browsing through the website, searching information, making the transaction and interacting with the provider. However, we need to know that shoppers do not evaluate these steps separately, but as an overall experience. Thus, it is necessary that the whole experience is perceived positively.

2.7 Pricing strategies and segmentation

Increasing profits is an essential requirement in any business. One of the key levers to increase sales and profitability is the price. Therefore, pricing of products is among key aspects in business strategy (Hill 2013). As competition is getting higher and higher, companies are worried about keeping up with the expectations set by customers and therefore they deploy various strategic initiatives to attract and retain customers. The most common strategies companies use to gain market are pricing strategies (Chen and Iyer 2017). There are 9 main pricing strategies that are explained below.

Cost-based pricing is setting the price of a product based on the cost of its production, distribution and selling. On top of this, the company usually adds a fair rate of return in order to compensate for the efforts. In this pricing strategy the marginal profit gets easily balanced. However, there are some disadvantages with this strategy, such as, if the price is too low, this can undervalue the products, or if it is too expensive, it might lose its competitiveness. This strategy is also considered to be the weakest, since it is not putting focus on the customers' willingness to pay for the goods (Hinterhuber 2008).

Market-based pricing is a strategy where prices are set according to the current market prices for the same or similar products or services. If this strategy is introduced in the right way, it can help a company set the prices higher when a product is first introduced in the market and later align the prices with the market in order to stay competitive. It is often referred to as market-oriented pricing as it compares similar products offered on the market. The seller then sets the price higher, lower, or equal to the competition based on how well that product compares to the market.

Dynamic pricing is a strategy in which companies set flexible prices by taking into consideration costs, target margins, demand on the market and competitors' prices. In other words, it helps set optimal prices at the right time in response to real time demand, while at the same time considering the company's objectives. In order to have a dynamic pricing strategy, companies need to have real-time data and advanced technology to collect and organize data. Then through dynamic pricing, prices are immediately adjusted against any changes on the market.

Consumer-based pricing is a common approach companies use to set their prices. The company first sizes up its customer base in order to determine how much each individual customer is ready to pay for the products and later adjusts the price according to the customers' willingness to pay. This type of pricing gives the flexibility to charge different customers different prices, in order to match the size of each customers' wallet. The company can achieve high volumes of sales at the best margins, however, one of the problems is that this type of pricing might alienate those customers who end up paying more (Raju and Zhang 2010).

Bundle pricing is selling a range of products for a discounted price. The pricing of the product is based on a bundled offer and the price is lower than if the customer would buy the products separately. Bundle pricing can also have different forms, such as pure or joint bundling (Richards 2004). Bundling is based on the idea of customer surplus. Each customer has a price that he is willing to pay for. If a price is set close to that limit or below it, the customer will consider the price of the product as a bargain. The difference between what the customer will pay and what he is willing to pay is called surplus. Hence, bundle pricing is focused on capturing more of the customers' surplus.

Penetration pricing is a strategy used when a company enters a new product market with below average prices. Sometimes, brands are using this strategy in order to highlight a new product or a service and lure customers from competitors into their brand. Penetration pricing relies on using lower prices initially to a wider customer segment that is aware of the product. The key objective of this strategy is to persuade customers to try a new product and raise market share with the intention of keeping the newly acquired customers once the prices drop to normal. Some examples include online newspaper websites offering one-month free subscription.

Price discrimination strategy is a tailored pricing strategy when an identical product is sold at different price points to different customers. It includes three main levels:

- First degree: customers are charged the maximum price they are willing to pay.
- Second degree: customers are able to choose their price discrimination. For instance, they might be offered a different price if they buy the product in a larger quantity.
- Third degree: customers are charged differently based on different segments.

Loss leader pricing is a strategy mostly used for offering supplementary items together with the main product, which in turn improves the product line and sales (Hsieh and Dye 2017). This strategy is usually used in grocery stores when selling one product together with multiple supplementary products from the same brand. In e-commerce loss leaders expect that once customers are on the website they will likely buy other normally priced items.

Price skimming is setting high prices for a product during its introductory phase. Companies using this strategy are trying to leverage the newness of the product and maximize sales and profits. As the demand for those customers is satisfied and the competition starts entering the market, the company lowers the price to attract the price sensitive customers. This strategy is opposite from the penetration pricing which is focused on lowering the price to gain as much market share as possible in the early stages.

3 METHODOLOGY

This chapter includes a description of the research methodology for this thesis as well as the steps taken to conduct the research. In the beginning, the research approach and methods are discussed. Afterwards, a description of the type of data being used is given. Lastly, the research model is shown, and the methodology used is summarized.

3.1 Research Approach

There are three main types of research approaches in academic studies- inductive, deductive and abductive. The deductive approach is comprised of analyzing previous literature and making logical conclusions from the content in the form of hypotheses and prepositions. Afterwards, these prepositions are tested, and conclusions are laid out for proving or disproving the hypotheses. On the opposite side, inductive approach focuses on observations which result in theoretical frameworks (Kovács and Spens 2005). The abductive research is a combination of the deductive and inductive approaches and moves between inductive and open-ended research to more hypothetical and deductive attempts to verify hypotheses (Dubois and Gadde 2002).

A general inductive approach is most commonly used when analyzing qualitative data. The aim of using this approach can be to condense raw data into a summary format, to establish links between the research objectives and the summary findings or develop a framework from the data. It uses systematic procedures for analysis of qualitative data and can produce valid and reliable observations.

This thesis will be based on an inductive research approach. This approach is especially suitable for the problem being analyzed in the thesis, since e-commerce has been studied intensively and theoretical frameworks have been laid out prior to this study. An inductive approach often leads to better interpretation of the phenomena and analyzes them from a different point of view. In addition, it provides suitable ground to gain novel insights about the impact and evolution of online shopping within the fashion industry.

Therefore, in this thesis, the literature will be examined together with data collected empirically, and the observations and results will be presented. Furthermore, the results will be analyzed in a wider context and connected to the examined theory, so as to give answers to the research questions.

3.2 Research methodology and analysis

This segment consists a broad view on the type of research method that exist as well as the method used in the thesis. In addition, it provides an explanation of the analysis method used in the thesis.

3.2.1 Types of research methods

There are two main research methods used in academic studies: quantitative and qualitative method. The quantitative method relies on a deductive approach through hypotheses or theory testing. It uses gathering and analysis of quantitative data. To the contrary, the qualitative research is often regarded to as subjective and focused on expressions, meaning and descriptions. It relies on a broader approach by setting research questions. The results obtained through qualitative methods are usually descriptive and inferences can be drawn from the data (Bell, Bryman and Harley 2018).

This study will be based on a qualitative research method. The goal of using this method was to get rich material from previous studies and literature and draw conclusions on some aspects of e-commerce that have not been fully tackled. There are many types of qualitative methods that can be used in a study, like in-depth interviews, focus groups, ethnographic research and content analysis. For the purpose of this study and the objectives set, a content analysis will be conducted in order to synthesize the literature.

3.2.2 Analysis method

In order to analyze qualitative data, there are many types of methods that can be used, such as, phenomenology, grounded theory, ethnography, and content analysis (Burnard 1995). Unlike the other types of analyses, content analysis is not connected to a concrete science and does not follow specific rules. Hence, there is less risk of confusion in areas concerning theoretical concepts and discussions. When applying content analysis, the researcher must rely on the qualitative research, and the primary issue is to accomplish the credibility that makes the results trustworthy. There are many concepts of trustworthiness that can be used, and it is possible that a researcher uses the same concepts as in quantitative studies, something that is not allowed when performing the other forms of qualitative analysis (Long and Johnson 2000). With the help of content analysis, the volume of the text can be reduced, and specific patterns within the data can be analyzed. It identifies and groups similar categories in order to seek understanding of those concepts. By conducing the content analysis, the researcher is able to stay true to the textual data analyzed and achieve the credibility and rigor that is present in quantitative data analysis (Patton 2014; Morse and Richards 2002). There have been many attempts to define content analysis and describe it as an analysis method over the years. According to Berelson, in 1952, content analysis is defined as “a research technique for the objective, systematic and quantitative description of the manifest content of communication". He argued that content analysis is a reliable method that impedes the individual control of the researcher. However, this definition did not include the qualitative component of the analysis. In an attempt to include both the quantitative and qualitative nature of content analysis, Krippendorff (2018) defined it as "a research technique for making replicable and valid inferences from texts to the contexts of their use". Therefore, content analysis can be used for any form of text that is valid for the subject no matter where the material comes from and there are no specific rules to be followed (Berg and Lune 2001).

In this study content analysis is conducted on master theses, research papers, publications and interviews carried out between 2000 and 2020. The materials were sourced through online search which was based on key terms such as "e-commerce", "online fashion", "pricing", "customer returns". The results were reviewed and filtered, after which 95 references were used to address the research questions of this thesis. Afterwards, the data collected is approached through the lens of the theory behind the concepts. An analysis of the fundamental concepts relevant to the research questions is and conclusions are drawn from the analysis. This method incorporates a certain selection of topics. It needs to be noted that the study could therefore be written from a different perspective with the same data through choosing different topics of interest. The process thinking behind the methodology and analysis behind this thesis can be found below (Figure 4).

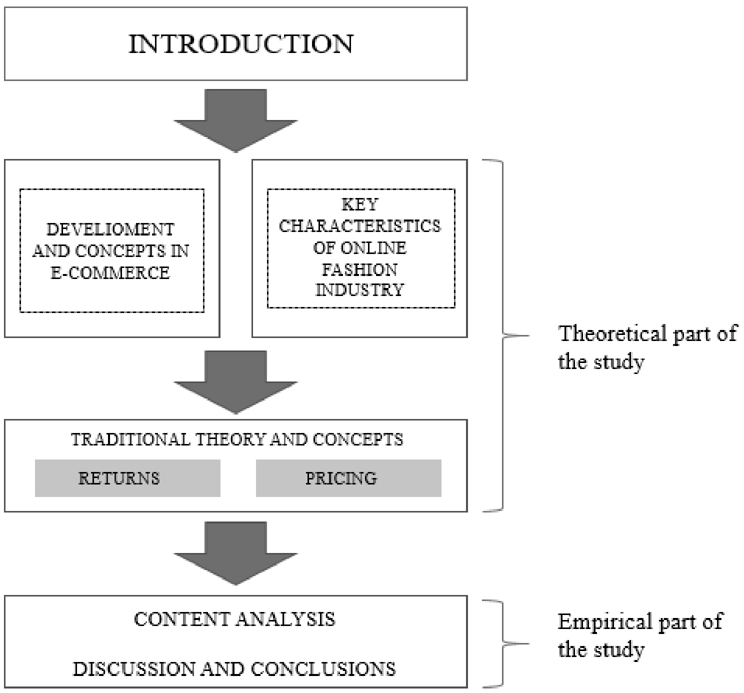

Figure 4: Research methodology

3.3 Quality criteria in research

There are three prominent features when evaluating an academic research: reliability, replication, and validity (Bell, Bryman and Harley 2018). However, further research discovered that other aspects are more appropriate for evaluating a qualitative study, such as the trustworthiness (Bell, Bryman and Harley 2018). Trustworthiness incorporates four main elements:

3.3.1 Credibility

Credibility refers to how believable the findings of a study are. This includes making sure that the study was done according to good practice and that the data used comes from credible sources. These elements confirm that the researcher has correctly understood the concepts that are subject of analysis. All of the data used in this thesis was therefore collected from credible sources of data and from credible authors.

3.3.2 Transferability

Transferability refers to the degree that the findings in a research apply to other contexts. The researchers doing a qualitative study are encouraged to comply to this criterion. On one hand, this thesis focuses on a specific sector within e-commerce, the fashion industry, but on the other hand, the findings can be used as a base for country-specific research or company research operating in the fashion industry.

3.3.3 Dependability

Dependability refers to the approach of auditing the research done, meaning that it is desirable to have other people review the work done. This criterion was accomplished through continuous mentorship with a professor from FM.

3.3.4 Confirmability

Confirmability refers to making sure that the researcher acted in good faith when conducting the research. The objective of this study was eliminating any personal opinions of the subject interfere with the way the research was conducted, and the findings derived from the data.

4 FINDINGS AND RESULTS

This chapter includes the relevant findings that are result of the content analysis completed on the empirical data. It gives an explanation of the relevant phenomena and concepts that are relevant to the study, as well as a deep analysis of the research questions.

4.1 The evolutionary role of e-commerce in the fashion industry

In order to understand and answer the first research question: *How has the role of e-commerce evolved in the fashion industry?* we need to get a closer look of the growth of fashion e-commerce, as well as, the factors affecting this growth. Therefore, in order to achieve the aims of the thesis, this sub-chapter will focus on understanding the reasons behind the development and how these factors will affect the future of e-commerce in the fashion industry.

4.1.1 The growth of fashion e-commerce

The global e-commerce fashion market is predicted to reach $765 billion by 2022, which represents an increase of $281 billion, or around 60%, from the year of 2018. In fact, by the end of 2022, 36% of total fashion retail sales are expected to occur online, up from 27% this year, which can be noted from the Figure 5 below (Mena 2018).

According to the study done by Forrester, 58% of the global online population has made an online purchase in 2018, and around half of that population has bought clothing, accessories or footwear. From the Figure 4 below we can also note that e-commerce has a stronger impact in the fashion industry than in the broader retail market: it accounts for 27% of fashion sales globally in 2018, compared to 15% broader retail sales (Mena 2018).

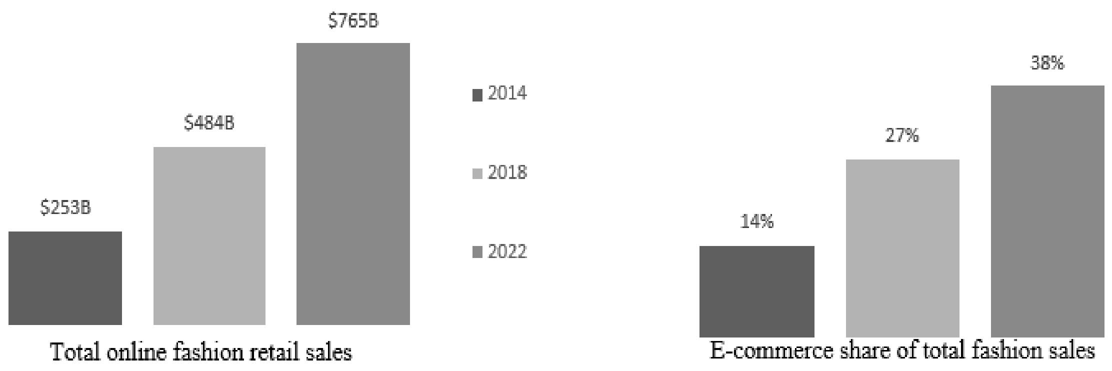

Figure 5: Online fashion retail sales and e-commerce share of total fashion sales

Source: Mena 2018.

According to the figures above we can clearly note the rapid growth of online sales in the global market. However, only few industries utilize e-commerce as much as the fashion and apparel industry. Big retailers that are blooming on the market are pushing the growth even further and demanding more. In that sense, we will have a closer look on some of the key factors that are affecting this growth according to various researchers. The factors will be divided in two parts: *main factors*, or factors that most researchers record as significant to the development of the online fashion industry, and supporting factors, or factors that are closely related to the main factors but are not as prominent.

4.1.2 Factors affecting the online fashion industry

Main factors contributing to the development of the online fashion industry:

Firstly, the middle class has seen significant increase in purchasing power. The middle class, with developed taste for fashion away from the informal market and experiencing rising levels of disposable income will be the key demographic to drive the evolution and growth of e-commerce in the fashion market (McKinsey and Company 2018). According to the metric used to measure the purchasing power, ARPU or average revenue per user, the purchasing revenue of apparel and accessories customers has increased from more than $265 in 2016 to more than $280 in 2020 (Statista 2020). In some regions the spending on fashion is between $500 - $1600, most notably in Saudi Arabia and the United Arab Emirates respectively. The majority of the consumers fall between the 16 to 24 and 25 to 34 age brackets, which is the target customer segment group for most fashion e-tailers. This means that the fashion e-commerce will experience a surge in shopping as the number of customers willing to make a purchase is forecasted to increase from 844 million in 2016 to 1.2 billion in 2020.

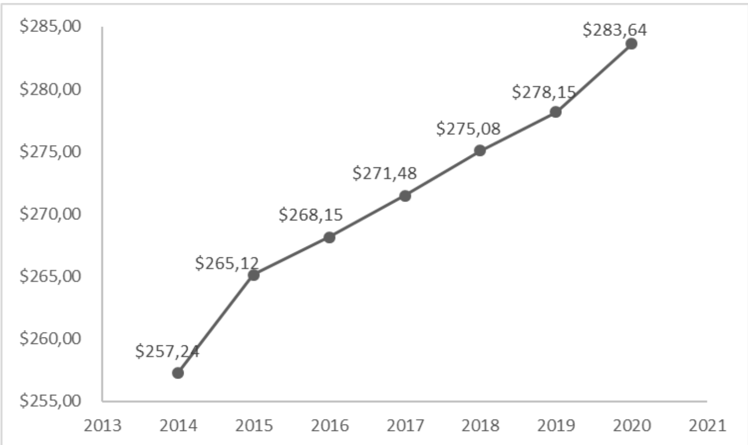

Figure 6: ARPU in the clothes and accessories market (worldwide market)

Source: Statista 2020.

Another growth driver of e-commerce is the increased Internet access for consumers in emerging markets, especially among lower- and middle-income groups. Furthermore, the increase in smartphone usage in such markets plays a key role (Bandi et al. 2018). Consumers from emerging markets such as Middle Eastern consumers are becoming increasingly connected to the online marketplaces. The penetration of the Internet in Saudi Arabia and the United Arab Emirates is between 89%-99% respectively (McKinsey and Company 2018). E-commerce is therefore becoming a popular platform for apparel shopping in the region. The penetration of the internet is set to rise from 2% to 9%, while in some fashion categories in Saudi Arabia it has already exceeded 20%. In these markets, internet platforms are thriving and international online fashion companies such as Amazon, Farfetch and Net-a-Porter are frequently used among the customers. The growth is also notable in Asian-Pacific countries. According to, McNair (2017), the number of smartphone users in the Asia-Pacific region reached 1.33 billion in 2017, an increase of over 11.8% from the previous year. The trend towards a more mobile, social, and personalized shopping experience is expected to speed up as hundreds of millions of new smartphone users in emerging markets are expected to join the middle class. This means that more and more e-commerce companies will try to capitalize on the rapid growth in emerging markets in the quest of achieving high profitability.

The main trends in the online fashion industry are mainly centered around personalization and treating every visitor as an exclusive customer. Personalization refers to dynamically curating experiences to individual customers in seamless fashion across the entire value chain (Keskin 2020). In reality, personalized experiences are quickly becoming a desired standard as a study on customer behavior revealed that 70% of consumers expect companies to interact with them on a more intimate level online (Hong 2014). This includes interaction on every chain of the experience: from marketing to online shopping and service. In addition, a recent report from Accenture revealed that as much as 91% of consumers are more likely to purchase from a brand that remembers them and provides relevant offers and more than 80% of the respondents in the study said they were willing to provide their personal data in exchange for a personalized experience. This factor can be very influential, since having a good personalization practice in place can mean high conversion rates for the online brand.

As mentioned in the theoretical background of this thesis, creating trust can have a vital role in B2C e-commerce. Gaining trust helps customers engage with the brand and encourages the use of the electronic technologies, makes the payment process easier and enhances the commitment of customers. This eventually leads to higher satisfaction levels, creates loyal customers and maintains a long-term relationship with customers. Such a competitive advantage of an online brand can lead to higher price tolerance among loyal customers, it reduces their concern of information privacy, and makes them more tolerant of irregular mistakes made by the online brand (Pittayachawan, Singh and Corbitt 2008). However, it is becoming extremely difficult for companies to provide both personalized experiences and gain trust, due to increased privacy concerns. Such issues sparked the movement Do Not

Track, and the fight against the use of cookies as a preference tracking device. In the years to follow, gaining customers' trust will possibly become a business asset that creates significant advantage. As we have seen, in the fashion e-commerce there is willingness among the customers to trust the brand with personal information in exchange that their data is used to offer tailor-made products (Winkler 2015).

Supporting factors that affect the development of e-commerce:

Fraud and information security as mentioned in the trust segment of the study, from a customer perspective, are a big obstacle in the growth of e-commerce. The perception of risk surrounding internet transactions has been recognized from both experienced and inexperienced users. In addition, it has been identified that the main concern of online shoppers is fraudulent behavior of online stores (Miyazaki and Fernandez 2001). This is mainly due to the opportunity of online hackers to access online databases and steal sensitive shopper data. Moreover, cyber-attacks bare high costs to the business. Many companies do not disclose the costs incurred from cyber-attacks; however, data breaches can be very costly to the business (Minnaar 2014). Although most consumers are stress-free when shopping on well-known online fashion stores, data breaches and hacks happen even to the very best in the industry. For reference, a multi-million-dollar UK online clothing store was cyber attacked in 2018, exposing 1.3 million users to data breaches (Cluley 2018). Therefore, not only are security issues costly to the business, but they can create significant trust issues among customers and destroy the brand image (Price 2019).

Quality of products and materials used is one of the most important elements relevant to the online fashion industry. According to Kotler et al. (2011), product quality is defined as the degree to which the products is able to satisfy the proper customer needs. The product quality is also defined as the functionality of the product, its consistency with the specification from the online shop and the real quality of the product (Ahn, Ryu and Han 2004). Customers are more likely to visit an online fashion store that has a large range of offerings and high-quality clothing. If customers perceive the product as high quality, they will continue to visit the online store and repurchase from it. Therefore, perceived quality of a product has significant contribution to the ability of satisfying customer needs (Handoko 2016).

Sustainability has also been an increasingly important driver of purchasing decisions in recent years. Global issues such as population growth, waste disposal and climate change have contributed to the significance of sustainability in fashion. In addition, sustainability pressures have become present in the industry from both product and production processes. Especially, the speed of fast fashion retailers has contributed to the high consumption of water, emission of hazardous waste, violation of human rights in apparel production sites and larger gas emissions. Therefore, customers want transparency across the entire value chain: from the origin of the materials to the quality of materials used. To fulfill such demands, online fashion companies have tried to be more transparent, in certain cases disclose the cost of the materials used, the mark-up, labor cost and transportation costs. Initiatives have been taking place also on a cross-industry level which has helped brands identify best practices in sustainability and set standards for imports of the fabrics used and introducing specific innovative processes in the production of fashion items (Gazzola et al. 2019).

4.1.3 The evolution of e-commerce in fashion

As e-commerce development took the world by storm, e-commerce stores have gone an extra mile to lead the digital development of shopping and personalize customer experience. When e-commerce was firstly introduced as a shopping platform, only a small percentage of the world population had the trust and ability to shop online. However, with the increased Internet penetration in emerging markets, the expansion of the fashionable middle class and the increase in purchasing power, fashion e-commerce transformed from a side-channel to a main shopping channel. E-commerce is still shaping the fashion world as we know it, by introducing various incentives to make more customers shop online. New digital payment options have been offered together with tailor-made offers based on past purchases and matching clothing to customers' interests. Shopping online enabled customers to save valuable resources such as time and money they would otherwise spend shopping in brick-and-mortar stores. Nowadays, more and more traditional stores expand their channel or even fully migrate into an e-commerce brand, expanding their customer reach and staying in the competition. Thus, omnichannel fashion stores have become prevalent, which is evident from the fact that more than 73% of shoppers use multiple channels during their buying journey (Sopadjieva, Dholakia and Benjamin 2017). Another important platform for online shopping has become social media. With the improved capabilities of social media channels, the platforms have developed to more than just an advertising tool. Instagram, Facebook and other social media platforms have launched the buy buttons, and enabled shoppable posts, which allow online fashion businesses to add product tags on the posts and sell their products. The development of the emerging markets and the increase in their purchasing power, has also enabled the shift of the center of e-commerce from the Western hemisphere to non-western regions, most notably in Asia-Pacific and Middle Eastern regions. This means that e-commerce brands had to adopt an international approach to selling fashion and adapt their offerings to cultural and traditional segments appealing to the wider international public. In addition, such advancement in the developing countries, has resulted in more cross-border shopping, meaning that more customers are now shopping from brands outside their home-country. According to the Nielsen Company (2018), at least 54% of the global fashion shoppers, shopped cross-border in the last six months. Moreover, the mobile shopping revolution, enabled another way of conducting online shopping. Many fashion e-commerce brands have created mobile apps which give customers a second and on-the-go way of purchasing fashion items. The increased usage of mobile shopping mainly stems from the customers' desire to do shopping without having to use the desktop. As a result, more than

79% of users made a purchase using their mobile device (Smith 2020). The improvement in customer experience while shopping for fashion online is more than evident. The increase of Internet accessibility, the ease of payment and personalized offers together with the absence of the constraints in traditional stores have made online shopping a desirable option for customers. With that the role of e-commerce has significantly changed within the fashion industry: more and more customers shop-cross borders and through social media. In addition, the smartphone penetration has opened a new door for shopping that has set the standard and continues to demand more innovation from online fashion retailers.

4.2 The impact of e-commerce on pricing strategies in the fashion industry

Pricing has been among key competitive aspects for doing business since the emergence of the second merchant. It is still one of the key instruments used by retailers as it has a significant weight within the customer decision making process and subsequently in the success of the retailers' business (Zentes, Morschett and Schramm-Klein 2007).

One of the most discussed trends is the adoption of dynamic pricing, by which retailers leverage advanced technologies to adjust prices regularly, and often based on an underlying model. This strategy was initially deployed by the tech savvy online retailers such as Amazon and Alibaba. Ongoing technological advancements and changing customer behavior in the past decades has led not only to the emergence of brick-and-mortar retailers and brands to venture into e-commerce, but it has also led to the emergence of pure online retailers that do not own physical stores. The pure online retailers have amassed significant amounts of data on online purchasing behavior and pricing, which combined with their advanced data capabilities has given them space to use sophisticated pricing strategies to compete with multi-channel retailers. For example, Amazon generates on its own enough data needed to deploy dynamic pricing and studies on 100 random products have shown a price change range of more than 200% in the course of a year, with price change frequency of 5 days (Zhou 2018). To enable these tactics, Amazon has employed artificial intelligence engineers across all departments (Tucker 2018). As a next step, and following the technological enablement provided by digital labels, dynamic pricing is becoming reality in physical stores.

The emergence of e-commerce has added further complexity for merchants by increasing the levels of transparency to consumers across different stores and countries, thus increasing the ease of comparability. For fashion retailers, in their very beginnings of venturing into the online channel, it opened the question whether to adopt a uniform pricing for their products across the different channels, or to adopt a differentiated pricing that would correspond to the economics and competition of each particular channel (Melis et al. 2015). Such developments have in many cases led multi-channel fashion retailers to review their pricing strategies and invest in technologies and talent capable of implementing sophisticated pricing approaches. However, despite evidence that offering a different price for different channels is a viable strategy (Lii and Sy 2009), studies have shown that multi-channel retailers and brands have mostly adopted a uniform omnichannel pricing (Flores and Sun 2014). A more recent study conducted in 2017 on a large scale, and as part of the Billion Prices Project from MIT, analyzed online and in-store pricing among 56 large multinational multi-channel retailers across 10 countries. The findings suggested the prices online and in-store are the same 72% of the time (Cavallo 2017). Despite this, leading consulting firms McKinsey and Boston Consulting Group suggest their recent observations are evidence of an emerging trend by which more and more retailers are adopting differentiated pricing and reaping the benefits. A joint report between McKinsey and MIT Sloan suggests that WallMart in the US has started offering products cheaper in-store compared to the online store, with the aim to increase the in-store traffic which could mean higher consumer basket.

Among key reasons for management dilemma whether to introduce differentiated cross-channel pricing is evidence that consumers would perceive differentiated prices among channels as unfair (Wolk and Ebling 2010). Furthermore, a study by Accenture in 2014 reveals that nearly half of the surveyed customers (49%) expect retailers to further integrate the in-store and online shopping experience, suggesting expectations for unified pricing across channels.

In this chapter we will further study into how and when dynamic pricing is used in the online fashion industry, analyze the omnichannel pricing dilemma on whether to adopt differentiated pricing and look into the fairness of differentiated pricing from a customer perspective.

4.2.1 Dynamic pricing adoption in the online fashion industry

Increasing levels of price comparability has fueled pricing competition and has prompted many online retailers to adopt competition-based pricing which is dynamically updated based on changes monitored among their competitors (Fisher, Gallino and Li 2018). The strategy typically relies on a model which analyzes live datasets of competitors pricing and programs responses based on pre-determined model rules. For example, the model could suggest that a price for a certain product has to be higher or lower by a certain percent relative to the price set for the same product by a targeted competitor. This pricing practice is however very difficult to implement, which could limit smaller scale players of pursuing adoption of the necessary technology. The complexity arises from the need to incorporate inventory levels, high degree of market uncertainty and potential customers' purchasing behavior (Aviv, Wei and Zhang 2019). Larger players though have been practicing dynamic pricing for many years. For example, Zara, one of the most successful fast fashion brands globally and a mixed channel player, has been using a dynamic pricing strategy for over a decade (Caro and Gallien 2012). Ralph Lauren and Michael Kors are using advanced techniques that combine dynamic pricing with advanced stock keeping models backed up by machine learning (Couto 2020). More recently, a survey conducted on 1.200 Amazon marketplace sellers suggest that even smaller players that are using the Amazon marketplace to place their products and have revenues below USD 250.000 are using repricing software (Nadel 2018). This number is increasing annually and could be attributed by the ease of adopting a dynamic pricing strategy on the Amazon marketplace given that Amazon's platform is providing APIs that are engineered to enable algorithmic pricing (Chen and Iyer 2017). Alibaba, Amazon's Asian counterpart, has also been using the dynamic pricing approach on its online platform. As mentioned in the chapter introduction, some retailers after successfully using dynamic pricing for their online channels, have started adopting dynamic pricing in their physical stores. This approach is supported by installing digital shelf price labels. These labels are synchronized with the online prices and offers, so it is possible to adjust campaigns and flash sales with few clicks. Examples of such adoption include Hema in the Netherlands and Bjorkqvuist in Finland, both using the solutions form the technology provider EllaFashion since 2018.

4.2.2 The omnichannel pricing dilemma

With the emergence of brick-and-mortar retailers that ventured into the online channel, and thus became multi-channel stores, customers were faced with the omnichannel experience. Omnichannel experience is defined as multi-channel approach through which a firm strives to offer a seamless, and unified journey for the customer, no matter which technology, channel or platform the customer uses for the interaction (Khandelwal 2020). Pricing is inevitably part of the omnichannel customer experience, and so far it has been explained as providing the customer with unified pricing information across the retailers' channels. According to McKinsey and Company (2018), the typical trend with customers has been to look up competitor's prices for the same item while they are shopping in-store. But now it is suggested that a relatively new trend is emerging of checking the price of the same item with the same retailer across channels. According to the recent report, retailers are increasingly adopting a differentiated pricing across channels, with prices online being lower most of the time to reflect the lower cost base of the channel. There are exceptions of course, such as the example with Wal Mart earlier, though that example is on the basis of another strategy aimed at increasing in-store traffic. According to McKinsey, a differentiated cross channel pricing approach typically yields bottom line increase by 2-5%. It is important to note that customers have different sensitivities to differentiated cross channel pricing. In particular, the McKinsey study (with 2.400 participants in the survey) finds that customers are in general fine with items in store being more expensive relative to prices online as they value the closeness to the item and the fact that they can purchase the item immediately (Backer et al. 2018). However, and of importance to fashion retail, customers were less sensitive on the price differences with cheaper items, such as a USD 3.00 toothbrush, and more sensitive on price differences with more expensive items such as a USD 30.00 sweater. Customers were more tolerant (38% of the respondents would accept such a difference) when the price of the sweater was cheaper online, while only 18% of respondents were tolerant when the sweater was cheaper in-store.

Women were more tolerant for the sweater price differences than men were, and younger customers aged below 31 years were more tolerant (40% of respondents) compared to those customers older than 45 years (only 20%). It is interesting to note that Amazon Prime users were more tolerant to price online being higher than prices in store. McKinsey (2018) suggests this could be explained as a result of these customers having a different view to the online value proposition than the rest of the customers, in particular the convenience in ordering through a gadget and easy return procedures, overall finishing the task without spending time to visit the physical store. To successfully implement a differentiated omnichannel pricing strategy, firstly the company needs to deploy a dedicated pricing taskforce. In addition, employees in the physical store need to be well informed on the approach and be ready to explain the price differences to the customers that inquire the reasons. Not having an informed explanation could lead to confusion and damage the brand image. Furthermore, the company needs to be operationally prepared to undertake this effort. In particular, it needs to have integrated systems that share information in order to allow tasks such as in-store returns of items purchased online at a different price. Finally, the company needs to have leadership buy-in for such a step. The potential value of differentiated cross channel pricing needs to be well examined and communicated, and the potential risks addressed in order for top management to accept such a move. Besides McKinsey, another prestigious consulting firm Boston Consulting Group also suggests that retailers can reap significant value in adopting a sophisticated approach of differentiated pricing (Goad and Izaret 2015). They suggest that retailers should focus on distinguishing between items which potential buyers are more likely to compare against competitors' prices, and items that are less likely to be compared. This way BCG suggests retailers can differentiate cross channel pricing for the items that are less likely to be compared and optimize pricing. It remains to be seen if the trend of differentiated pricing does pick up in near future. As stated previously, the Billion Prices Project from MIT conducted in 2017 suggests identical pricing across channels in more than 70% of the investigated cases in the most comprehensive cross channel pricing study to date (Backer et al. 2018).

4.2.3 Fairness of differentiated pricing from a customer perspective

One of the key roadblocks for online retailers to adopt differentiated pricing across channels, as discussed previously, is the impact to the brand image due to customer perception. According to the recent McKinsey publication (Backer et al. 2018), online retailers are hesitant to adopt such strategies as there is no clear consensus in the surveys to date on the question if customers are willing to accept differentiated pricing across channels. The surveys suggest that customers across different demographics have different tolerance to such differences. Previous studies (Wolk and Ebling 2010), come to similar conclusions suggesting that firms are not pursuing differentiated pricing as they fear customers will perceive such move as unfair. Braz Becker et al. (2016) find that there is a controversial relationship between a differentiated cross channel pricing approach and perceived fairness, thus they conducted experiments by introducing boundaries in their research in an attempt to provide clarity. In their study they differentiate between the product being sold (product vs. service) and explanation type (cost vs. benefit vs. no explanation). What is important for the fashion industry is that products price differentiation across channels could be perceived as fair. They conclude that ease of evaluation of channel performance significantly interferes in the fairness perception of differentiated pricing between in-store and online. Wolk and Ebling (2010) come to the same conclusions. Good examples of channel performance interference are if we compare a laptop and a sweater. Laptops are frequently sold online, and customers have easy access to the product characteristics required to assess their value (e.g. operating system, memory capacity, display quality etc.), thus a noticeable price difference across channels would be perceived unfair. On the other hand, a sweater is more difficult to be evaluated online as customers typically need to try it on in order to evaluate how well the product is suited for their needs. Regardless of the amount of information the online channel offers for the sweater, it is not possible to try the sweater on. Consequently, the performance of the in-store channel is better in this case and customers would perceive higher price as fair. When it comes to the type of explanation for the price difference, customers appear to find fairer an explanation based on the lower cost base of the online channel (thus lower prices online) compared to an explanation based on the benefits of the channels. However, in both cases there was a marginal difference to the option of no explanation. A possible explanation could be that in the case of no explanation, the cost based underlying cause for the price difference is likely inferred by the survey respondents. In any case, they provide with managerial suggestion that companies offering products should introduce differentiated pricing across channels due to benefits recorded in previous research (Cheng, Chen and Chang 2008; Wolk and Ebling 2010), and also accompany the price difference with an explanation that is based on the different cost base of the different channels.

4.3 Customer returns and their impact on customer loyalty

This sub-chapter contains a closer look into customer returns as part of the online policies set by fashion e-tailers. In addition, the relationship between returns and loyalty is examined and certain strategies that online retailers have undertaken in order to combat high return rates. This is examined in order to get an answer to the final research question: *How have customer returns evolved in e-commerce and what is their impact on customer loyalty?*

4.3.1 Customer returns in fashion e-commerce

As pricing strategies are key for the decision making of customers, return policies have also played a great role in the customers' decision whether to purchase from a specific brand. The rapid growth of e-commerce has drastically changed the global marketplace. In fact, online customers are far more demanding than customers of the past and the logistics of businesses that are trying to satisfy those demands are scrambling to adjust to the online world. Adjustments are needed in the modern supply chain trends, but also to managing the return rates that skyrocketed with the introduction of e-commerce.

Returns play a big role in customer satisfaction, supply-chain management and if not managed properly, can pose a significant threat to the costs for shipping, delivery and liquidation (Tang 2016). For many e-commerce companies, reducing returns is a key objective since studies have shown that up to one third of all products sold over the Internet have been returned (Banjo 2013). While in traditional retail stores, the return rates are between 8-10% of total sales, the returns are exorbitant for online fashion retailers (Figure 7), where returns can reach and exceed 50 percent of the total sales. This can be detrimental to the loyalty of customers as well as to the profitability of the business.

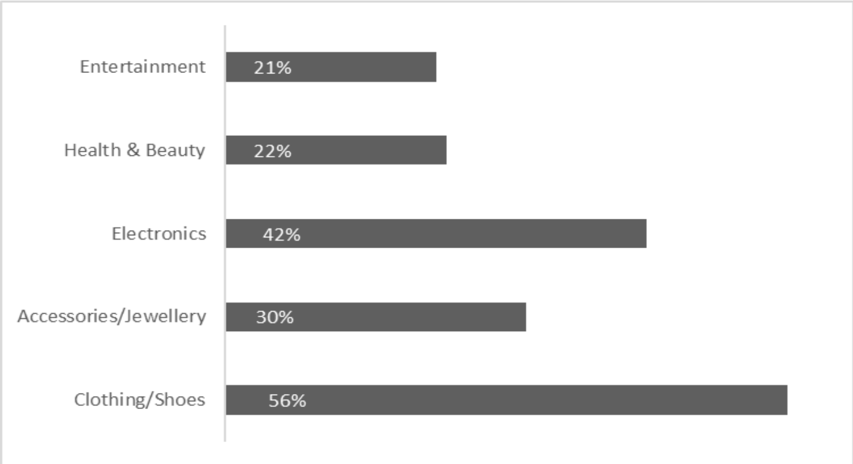

Figure 7: Return rates per product type

Source: Statista 2020.

Customers are increasingly demanding free returns and shipping as an incentive to continue purchasing (Figure 8). Customer demand in the area of returns is driving the change in logistics. Online customers are requiring simplicity and better options in terms of returning purchased goods and as a result online companies are offering expanded methods for returning items. Early on, big companies such as Amazon, tried to take advantage of this requirement and offered free shipping and returns to their customers. For reference, Zappos, a shoe company owned by Amazon, was one of the first companies to introduce a 365 days full-refund policy. Competition, such as Nordstrom, later followed the trend in the hopes of being able to compete with the market leaders. On the other hand, smaller and niche fashion e-tailers, are struggling to adopt such policies, since they can shrink their margins (Schiffer 2019). Companies need to especially look after the so-called serial returners, who deliberately over-purchase items online so that they can return the ones that they do not want to keep. In addition, customers buy multiple sizes of the same product with the intention of returning the items that don't fit properly. Research has also shown that product fit is a major cause of returns (Anderson, Hansen and Simester 2009). According to the research done by Shopify which included surveying more than 100.000 customers, more than 72% of the returns are customer preference related, such as, fit, size or style of all returns in the fashion category. Non-preference-based returns, like defective items, accounted for only 10% of total returns.

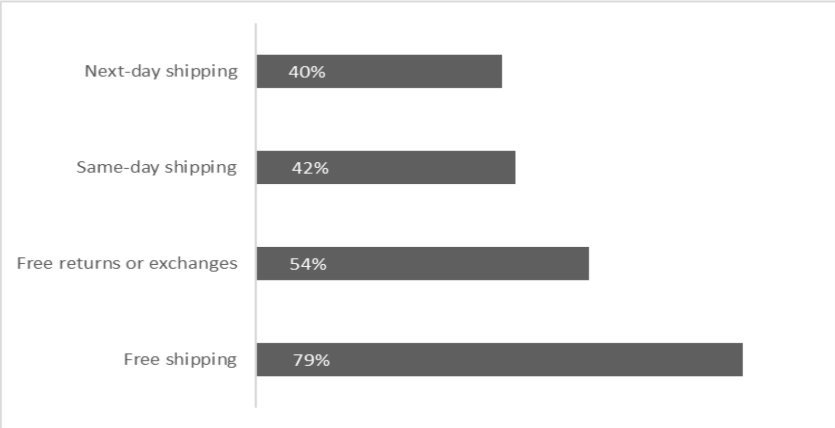

Figure 8: Incentives that would make a customer shop online-survey

Source: Statista 2020.

4.3.2 The cost of free returns

Although offering hassle-free and free returns can positively impact on the loyalty and satisfaction of customers, sustaining such initiatives can be significantly unaffordable. KPMG, a famous accountancy company, found that the cost of handling a return can be as high as three times the cost for delivering the item in the first place. Fashion retailers are especially hit by the returns, as consumers exchange the traditional fitting rooms for the comfort of their homes. The high costs are mainly due to the complex systems behind the logistics and the way stock is managed. Online retailers need to have secure warehouses where they can store the returned items and secure them from damage. According to the CEO of Mondetta, an e-commerce apparel company, if an item that costs 40 dollars is returned by the customer, this can cost the brand up to 15 dollars in shipping and handling (Winkler 2018). Similarly, the fashion e-commerce brand Revolve noted 385 million of dollars of returns in 2017, almost equal to its $400 million sales net of returns, according to the company's IPO. This means a roughly 49% product return rate, excluding the costs for the return shipping (Schiffer 2019). As e-commerce continues to grow, return rates have spiked 95% in the last five years. Forecasts predict that the value of returned items will rise from $350 billion in 2017 to $550 billion by 2020, just in the United States. The new normal of the free return policies have created a cycle in which even the big players like Amazon cannot keep up, and as a result the e-commerce leader has tightened its policies. The costs continue to increase as the returned items reach the warehouse of the seller. The goods usually end up on the shelfs for years, piling up additional costs for storage until they are donated or disposed. This significantly increases the costs for the online retailers, especially in regions where storage is limited, like in the United Kingdom. Around 10% of the total returned items are donated, while the rest is reassessed for damage before being dry-cleaned and sent for resale or disposed. All of this time lost in the shop windows of the online fashion retailers, ends up in the items potentially being sold at a discount. That being said, online fashion companies are aggressively trying to solve this margin eroder, a topic that will be discussed in the following chapter.

4.3.3 Strategies that online fashion retailers use to battle returns

Online fashion retailers are increasingly using technology as a way of battling the return rates which are crimping their margins. By offering personalized customer experiences and making the shopping process more interactive and fun, online companies are overcoming the issues of return. Furthermore, there are several trends that fashion companies are following:

Fit technology for virtual sizing is one of the biggest trends in online fashion, which offers virtual sizing tools that help customers make a proper purchasing decision. Companies have been increasingly investing in smart technologies which give customers a fitting option where they can compare the clothing online to that in their wardrobe (Sentanace 2020). In addition, the brand is able to accurately use 3D technology in rendering the clothing on customizable digital body models. Some of the technologies used by brands also offer the possibility to scan customers' footwear and get recommendations on what types of shoes would fit each individual. These tools work on the principle of online fitting rooms that enable brands to adjust their design and sizing as well as adapt their entire chain. The technology has proven to bring significant ROI in some cases. For instance, one shoe online retailer recorded fit related returns to decline for 23% after such technology was introduced (Schiffer 2019).

Interactive quizzes and games are used increasingly as a way to uncover customers' preferences in terms of style, color, look and size (Wallace 2019). E-commerce has developed as transactional in nature, mainly due to the development of marketing tools that evolved to accurately identify customer preferences. These surveys are an interactive and fun activity for customers, while for companies they provide invaluable shopper data by collecting size and fashion data. It also helps remove any inconsistency in what a customer refers to as their style and the style they actually have in mind. In addition to quizzes, many companies use gamification as an interactive tool to find out what their preferences for fashion are. These strategies help tailor clothing to specific customers and suggest appropriate offers.

Personalization is used by online fashion retailers as a way to distinguish high-value customers from customers that are deteriorating the company's profits. Using a segmentation model for customers can mean significant reduction in the return rate and thus preserve higher margins. According to research, specific customers are fifteen times more likely to return clothing than other customer groups. By having a clear view on which customers are serial returners, companies can personalize their offerings, such as, not providing significant discounts to returners, not offering returners free shipping and recognizing which clothing products have a higher possibility of getting returned. In fact, companies can use personalization to reward loyal customers who do not return items often by offering them promotional items and discounts. To achieve this, online retailers use algorithms to segment customers based on past purchasing behavior and predict which customers are more likely to return the purchased item.

4.3.4 Customer returns and customer loyalty

Based on a study done by Martinez (2010), offering flexible returns and customer repurchase are directly correlated. The study suggests that if customers perceive the return process as inconvenient, 85% of them would not repurchase from that brand. On the other hand, when the return process was living up to their standards, a whooping 95% stated that they would purchase again. According to Gronroos (1998), every return made by the customer should be seen as a service improvement potential for the online retailer. However, to claim that returns can be seen as an improvement opportunity, in the modern era this might be misleading. It is possible that a customer is unsatisfied with the experience even if the online store perfectly delivers the purchased item. Nonetheless, a return gives an opportunity to the online brand to understand the reasons behind the return (Boyer et al. 2007). According to Andreassen (2000), loyalty is more important that satisfaction as a strategic objective and service directly affects loyalty. This is why it is extremely important for fashion retailers to know how the customers evaluate the product return experience and which aspects positively impact loyalty. Boyer et al. (2007) identified three main aspects positively connected to loyalty: the perceived value of the returns, satisfaction with the returns process and previous experiences. The first aspect, or perceived value of the return process refers to the perception that the customer has on the full end-to-end return process and management system, including the conditions of the return policies. The satisfaction element of the returns process reflects a particular return transaction of the customer with a specific company. Such experiences predetermine the customer's expectation when dealing with another return process in the future. In addition, the easiness of use of the company webpage can influence the perceived value of the returns process as well as the satisfaction level. Also, these variables are influenced by the physical aspect of the return process, or how difficult it is for the customer to return the item, like packaging and shipping the item back to the seller. Therefore, we can say that there is a positive relation between customer loyalty and return process, and the better and hassle-free returns are, the more likely that the customer will be loyal and repurchase from the brand again.

5 CONCLUSION

This chapter contains the main summary and conclusions on the findings of the thesis. It summarizes the key elements in order to answer the main research question: *What is the impact of e-commerce in the fashion industry from a pricing and customer returns perspective?* Furthermore, it contains suggestions for further studies that can be relevant to the topic.

5.1 Summary

E-commerce in the fashion industry has been constantly rising in recent years and is set to reach almost 40% of total fashion sales by 2022. With the fast pace of technological development and adoption, we can expect online fashion industry sales to exceed in-store fashion industry sales in the near future. This thesis focused on the pricing strategies and returns aspects that the rise of e-commerce has had on the fashion industry, as these have been among key elements in the battle to win customers.

Regarding pricing, we can conclude that the emergence of e-commerce has led to widespread adoption of dynamic pricing among both mixed channel retailers and pure online players as evidence suggests that it leads to price optimization and increased profits. Recent technological development has enabled this technique to be adopted also in physical stores through digital labels, enabling multi-channel players to synch prices and promotions instantly between the online and the in-store channels. Furthermore, with the emergence of multi-channel players the dilemma of price differentiation across channels has struck multi-channel players. The most comprehensive studies to date suggest that prices across channels are identical more than 70% of the time, but prestigious consulting firms suggest that there is rising trend of players adopting a differentiated pricing approach in their efforts to maximize profits. Main concern for management has been the perceived fairness of such a move by customers. This varies across type of products and demographics. In particular for the fashion industry, the research suggests that customers are willing to accept higher prices in stores as they can try the product and make a better decision, thus appreciating the better performance of the physical store vis-a-vis the online store. Such a move from a fashion retailer would be best to be explained by the different cost structures of the channels, instead of focusing on the benefits the channel provides to customers.

Regarding returns, the development and growth of e-commerce introduced the need to adjust the supply chain of online retailers to fit the new and complex technological reality. This also meant to rethink return policies so as to attract customers and stay competitive. Same as pricing, returns play a critical role in the decision making of customer purchases in the online fashion industry. To satisfy demand, companies started to offer free returns, however, this can be very costly to the business as returns account for over 50% of total sales in fashion e-commerce. Companies have tried to fight the returns by increasingly using technology as a way to learn more about their customers and distinguish loyal customers from serial returners. There is a direct correlation between returns and customer loyalty as proven by previous studies, so companies should adopt careful return reduction initiatives, such as those focused on better understanding the customer preference and style, instead of making returns more difficult to facilitate.

5.2 Recommendations for further studies

Further research can be conducted in various areas. A detailed research on the impact of e-commerce on other industries can significantly help compare the influence and evolution of e-commerce on various industries. Secondly, this research was qualitative in nature, however, it would be beneficial if a quantitative study is also conducted on various companies in order to be able to clearly conclude if the findings and conclusions from this thesis are applicable on an individual level. Thirdly, it would be interesting to further analyze this problem from a customer perspective. This can potentially lead to findings related to the perception of customers on e-commerce and how influential they believe it is to the business. Finally, one can study the impact of e-commerce on a broader level other than on pricing strategies and returns. For example, a study on the impact of e-commerce on marketing strategies, customer relationship management or product development can enrich the findings of this thesis.

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