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**When Buying a Diamond Starts With a Mouse**

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Correction Appended

MARK C. VADON is one of the world’s top diamond retailers, but wholesalers often decline to meet with him on the convention floor at jewelry trade shows. At the very least, many ask him to flip over his nametag so that no one knows who he is or what company he runs.

There was a time not long ago when pundits generally dismissed Mr. Vadon’s company, the online jewelry purveyor [Blue Nile](http://www.nytimes.com/mem/MWredirect.html?MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=NILE), as one of the dot-com boom’s more lamebrain creations. People might be willing to buy a book online, or a CD, and maybe a toaster, they said, but a $3,000 diamond engagement ring? The jewelry industry — or at least the high-end jewelry trade — seemed impervious to the Internet.

Not any more. Only a decade after it was founded in the infancy of the Web, Blue Nile ranks behind [Tiffany & Company](http://www.nytimes.com/mem/MWredirect.html?MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=TIF) and at least one other competitor, the Signet Group, in diamond ring sales, according to industry analysts. Experts also believe that probably only Tiffany’s and the [Zale Corporation](http://www.nytimes.com/mem/MWredirect.html?MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=ZLC), which operates more than 1,500 chain stores and an additional 800 kiosks, bought more diamonds from wholesalers than Blue Nile last year.

While Blue Nile has grown — and its stock has soared 54 percent, to $38.53 a share on Friday from $25 when it was first sold to the public in May 2004 — Main Street jewelers have seen their profit margins shrink and many of their brethren shutter their store doors. As a consequence, many retail jewelers refer to Blue Nile as the “evil empire” — or worse.

So far, the Blue Nile effect has been felt mainly by mom-and-pop jewelers on Main Street and in malls; much bigger, high-end retailers like Tiffany have been affected only on the margins. And Blue Nile’s influence is limited largely to diamond sales, particularly diamond ring sales, but those are often the cash cow for smaller jewelers, accounting for a disproportionate share of their revenue.

“Blue Nile is just busting the chops of everybody, especially in the sale of diamonds,” said Ken Gassman, a former Wall Street financial analyst who runs the Jewelry Industry Research Institute. Diamond jewelry accounted for nearly half the $59.4 billion in jewelry, including watches and costume pieces, that United States retailers sold in 2005, Mr. Gassman said.

Blue Nile and other Internet jewelers are not solely responsible for smaller profits at traditional jewelers nor for the loss of more than 3,000 independent jewelry shops since 1999. Main Street jewelers, after all, have faced tough competition for decades, from the Home Shopping Network and other television creations beginning in the 1980s to, more recently, [Wal-Mart](http://www.nytimes.com/mem/MWredirect.html?MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=WMT), Costco and other big-box retailers that are grabbing a large share of the low-end jewelry market. A spike in the price of gold and other precious metals has also eaten into jewelry store profits.

Still, Blue Nile’s influence has been big enough that many smaller jewelers have been threatening to boycott wholesalers that supply online retailers. At the same time, consultants have been earning a handsome living advising retailers struggling to compete with Blue Nile — teaching them to “romance the stone,” as one consultant, Shane Decker, put it, using industry-speak for stressing the whole diamond-buying experience over merely the price.

Blue Nile operates no stores, so jittery men browsing its Web site in search of an engagement ring that matches their love and budget cannot compare diamonds side by side — or even see what they have bought until they tear into an overnight-delivery package.

But still they buy. The average diamond ring bought at the Blue Nile site costs $5,500, twice the industrywide average of $2,700, according to Mr. Gassman and other analysts. Blue Nile’s finance chief, Diane Irvine, says that nearly every day, the company sells a ring costing $20,000 to $40,000. Last month alone, more than a dozen people bought diamonds that were so expensive — $50,000 or more — that Blue Nile delivered them in armored trucks with armed guards. (All sales come with a 30-day money-back guarantee.)

“I don’t get up every morning and curse Blue Nile, like some do,” said Mark Moeller, owner of R. F. Moeller Jeweler, a three-store chain in St. Paul. “But the Internet has certainly affected profitability; there’s no doubt about that.”

Gary Gordon, chief executive of Samuel Gordon Jewelers in Oklahoma City, was more blunt. “Ours is an industry in big turmoil over Blue Nile,” he said.

SHOP owners, if they wish to curse anybody, might better aim their invective at one of their own, Doug Williams, a Seattle jeweler who in late 1995 took to heart all the radio advertisements he was hearing that implored business owners to adopt an Internet strategy.

The personal computer boom had been very kind to Mr. Williams, who for years had made a good living selling jewelry to [Microsoft](http://www.nytimes.com/mem/MWredirect.html?MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=MSFT) employees and other newly minted millionaires. Yet when he paid a consultant $2,000 to create a basic Web site he called Internet Diamonds, he did not even own a PC. “I was like a caveman looking at a television,” he said of the first time he visited his online creation.

Mr. Vadon stumbled on Mr. Williams’s site after a frustrating visit to the Tiffany’s in San Francisco, where he had gone in search of an engagement ring. This was late in 1998, and Mr. Vadon, a recent M.B.A. graduate from Stanford, was a well-paid management consultant at Bain & Company.

Yet as he tells it, the sales clerks initially ignored him, presumably because he was dressed in a T-shirt, shorts and Birkenstocks. He felt still more exasperated once one of their lot deigned to wait on him and was not much help. “He said, ‘Buy the one that speaks to you,’ ” Mr. Vadon said. “And I’m thinking, ‘This is absolutely nuts.’ ”

Tiffany’s declined to make a spokesman available for this article, but in a prepared statement said its diamond sales continue to grow, despite Blue Nile, confirming “the strong appeal of Tiffany’s diamond jewelry and the Tiffany & Company shopping experience.”

The two rings that Mr. Vadon was considering, at $17,000 and $12,000, would have represented the most expensive purchase of his life, automobiles included. So in search of what he described as a “Consumer Reports-like site,” Mr. Vadon ventured online, where he discovered a basic tutorial written by Mr. Williams. There he learned enough to consider tradeoffs between size, shape and his tolerance for imperfections — and also found, for $5,800, a diamond ring nearly identical to the less expensive of the two he had viewed at Tiffany’s. He bought it.

A more unlikely diamond retailer is hard to imagine. Mr. Vadon, who sports a permanent stubble look, wears no jewelry — not so much as a ring. On a recent day in Seattle, where Blue Nile is based, he was dressed in a rust-colored zippered pullover shirt and tan corduroys, and looked every bit like a man not quite comfortable in the spotlight but a numbers cruncher who finds himself the chief executive of a publicly traded company through happenstance.

By chance, Mr. Vadon was in Seattle on business a few weeks after he bought his engagement ring, and he stopped at Mr. Williams’s store. When Mr. Vadon offered that he had probably been a very good customer, Mr. Williams told him not really: he sold one or two diamonds a day online, and at just under $6,000, Mr. Vadon’s purchase was more or less an average sale.

Standing inside Mr. Williams’s modest, two-employee store near the Seattle airport, Mr. Vadon did a quick calculation in his head. At that point he may have known little about diamonds, but he recognized that an Internet site that cleared $250,000 a month in revenue despite no advertising budget and a bare-bones design could be extremely valuable. So at dinner that night, he offered Mr. Williams $5 million, which he did not have, for an 85 percent stake in his company — a deal penciled on a napkin and contingent on his raising the money.

Mr. Vadon was then 29, and unlike most of his Stanford business school classmates, had shown no great interest in the Internet. He had no experience selling jewelry. But this was Silicon Valley circa 1999, so in just eight weeks he raised $6 million to buy the site and ramp up its development. Over the next 12 months he raised an additional $44 million without, he said, having to work terribly hard at it.

The overabundance of cash engendered bad habits. The company, which at the end of 1999 switched to the more exotic Blue Nile name, booked $44 million in revenue in 2000, its first full year under Mr. Vadon, but managed to lose $30 million, largely because it spent $40 million advertising on television.

Blue Nile was hardly the only dot-com to burn through so many millions so quickly. [Miadora.com](http://miadora.com/), another jewelry site, raised more than $50 million in venture capital.

Shrewd business decisions kept Blue Nile afloat. First, it cut its work force sooner than most dot-coms, beginning in the summer of 2000. Second, its backers invested an additional $7 million in the second half of 2001, when many investors would not sink another dime into a consumer e-commerce Web site. Mr. Vadon, meanwhile, eliminated the advertising budget and hoped that consumers would still find his site.

“Either we were going to build this thing through word of mouth,” said Darrell Cavens, Blue Nile’s marketing chief, “or we were going to see revenues collapse and we would all go home.” Sales slowed in 2001, rising barely 10 percent, but then grew 30 to 50 percent annually over the next three years. That let the company start advertising again — limiting itself almost exclusively to the Web — while showing the kind of steady growth in profits that Wall Street now needs to see before most companies can go public.

After the dot-com bubble burst, “there was this giant sigh of relief” among jewelry retailers, said James S. Porte, the former chief marketing officer of [Diamond.com](http://diamond.com/) who now runs a marketing firm in Fort Lauderdale, Fla. “People hated Diamond.com and Blue Nile and the rest of them, and so they could say, ‘See, I told you it would never work,’ ” he said.

When Blue Nile refused to die, jewelry store owners reacted by pressuring wholesalers to cut off its supply. “People would meet at conferences and talk about embargoes like this was the Cuban missile crisis,” said a New York-based diamond wholesaler and Blue Nile supplier who declined to be quoted by name because, he explained, “I don’t need the grief.”

IT is easy to sympathize with the Main Street jeweler confronting a rival like Blue Nile. It operates no stores, only an office in downtown Seattle and a modest-size warehouse on the outskirts of town, so overhead eats up just 13 percent of its revenues, compared with 30 to 40 percent at a traditional Main Street retailer.

That allows Blue Nile to sell its diamonds at roughly 20 percent over cost and still make money, Mr. Vadon said and analysts confirmed. By comparison, the typical jewelry store sold its rings for 48.7 percent above cost in 2005, though that is down from 51.6 percent in 2002, an annual survey by Jewelers of America found.

As a result, Mr. Gassman, the analyst, found in one study that Blue Nile sold rings for 35 percent less than comparable rings at Zales.

David H. Sternblitz, the treasurer of Zale, in Irving, Tex., said: “The Internet business serves a target customer looking for a commodity that’s basically sold on price. There’s still a large segment of the population that wants to come into a store and inspect the jewelry, and wants the extra services we provide like cleaning and repair.”

In addition to its lower overhead, Blue Nile has a second advantage, at least over smaller jewelers. It bought roughly $170 million worth of diamonds last year, giving it the purchasing power to sometimes sell its diamonds at a cost below the wholesale price available to smaller stores.

“You can buy diamonds cheaper from Blue Nile than you can from most brick-and-mortar stores, including mine,” said Jerry Robbins, the chief executive of Robbins Diamonds, a five-store chain in the greater Philadelphia area. “But their big disadvantage is that customers cannot see the diamonds, they cannot touch them and they cannot compare them side by side.”

For now, diamond rings account for 70 percent of Blue Nile’s sales, and other diamond purchases — diamond post earrings, for instance — account for an additional 20 percent. The mark-up on designer jewelry — as well as on pearls and colored stones like sapphires and emeralds — still exceeds 50 percent, according to Jewelers of America.

But diamonds serve as the financial backbone for jewelers nationwide, and while some have tried to match Internet prices, many still refuse to compete on that basis. “Their attitude is, ‘Our prices are higher but we provide you services, and we’ll hold your hand, and we’ll wrap it up all pretty and such,’ ” Mr. Gassman said.

Will that work?

“I think it’s relevant that we have seen an acceleration in the closure of specialty jewelers in recent months,” he replied.

Correction: January 14, 2007

An article last Sunday about Blue Nile, an online diamond jewelry company, referred incorrectly to its relative standing among companies that sell the most diamond rings in the United States each year. Although jewelers do not provide comparable statistics about diamond-ring sales, Blue Nile does indeed rank behind Tiffany & Company. It also ranks behind at least one other competitor, the Signet Group, which operates Kay Jewelers.

The article also referred incorrectly to Mondera.com, another online jeweler. It is still in business; it is not defunct. And the article misspelled the city where the Zale Corporation, the jewelry retailer, has its headquarters. It is Irving, Tex., not Irvine.

http://www.nytimes.com/2007/01/07/business/yourmoney/07nile.html?pagewanted=3&gwh=E76120B25A01DA9D0489F2C9A69CC484&gwt=pay&\_r=0