
ELECTRONIC COMMERCE - STRATEGIC CONSIDERATIONS

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I. Impact of Electronic Commerce

- General observations.

II. Elements of Electronic Commerce

- Framework for considering electronic commerce impact on strategy.
- Lessons from:
 - Retail brokerage
 - Office products
 - Travel and entertainment

III. Where to from here?

It is difficult to separate the hype from the real impact of electronic commerce.

- It is a self-fueling engine of exciting and entertaining “stories.”
 - A “.com” after a company name increases price/earnings ratios.
 - Cyber companies will drive traditional companies out of business.
 - Information services will extract value from business systems and change business models.
 - Friction disappears.

But we believe critical issues regarding real business prospects are being ignored.

- A. Evaluating opportunities compared to traditional business models is dangerous... because traditional business models will adapt.**
- B. Most of the generic models depend on customer “stickiness” to prove out. The extent to which customers are “owned” is a major issue. Could the real “portal” be your bookmarks? If this is an issue in consumer markets, how much more of an issue might it be in business markets?**
- C. Power of mass or many as the base of competitive superiority is questionable. Sites with huge information content may have limited advantage over more focused sites... particularly as screen refreshment times diminish.**
- D. The value of a “head start” in a particular business concept is far from decided. Costs of mounting a new competitive threat are small and shrinking.**

Electronic Commerce - Far Reaching Impacts on the Business Model.

FUNCTION

Marketing

Sales

Product Development

Distribution

Brand Equity

IMPLICATION

• Expanded market reach

• Higher sales productivity

• Clearer, more timely market needs

• Savage cost reduction

• Explodes or disappears

Strategically

• Less discrete investment decisions

• Accelerating product cycles

• Information the primary locus of value

• Diminishing half-life of intellectual capital

• Inadvertent competition

• Increasing penalties for slow decision making

• Loss of profit shelter from habit or friction

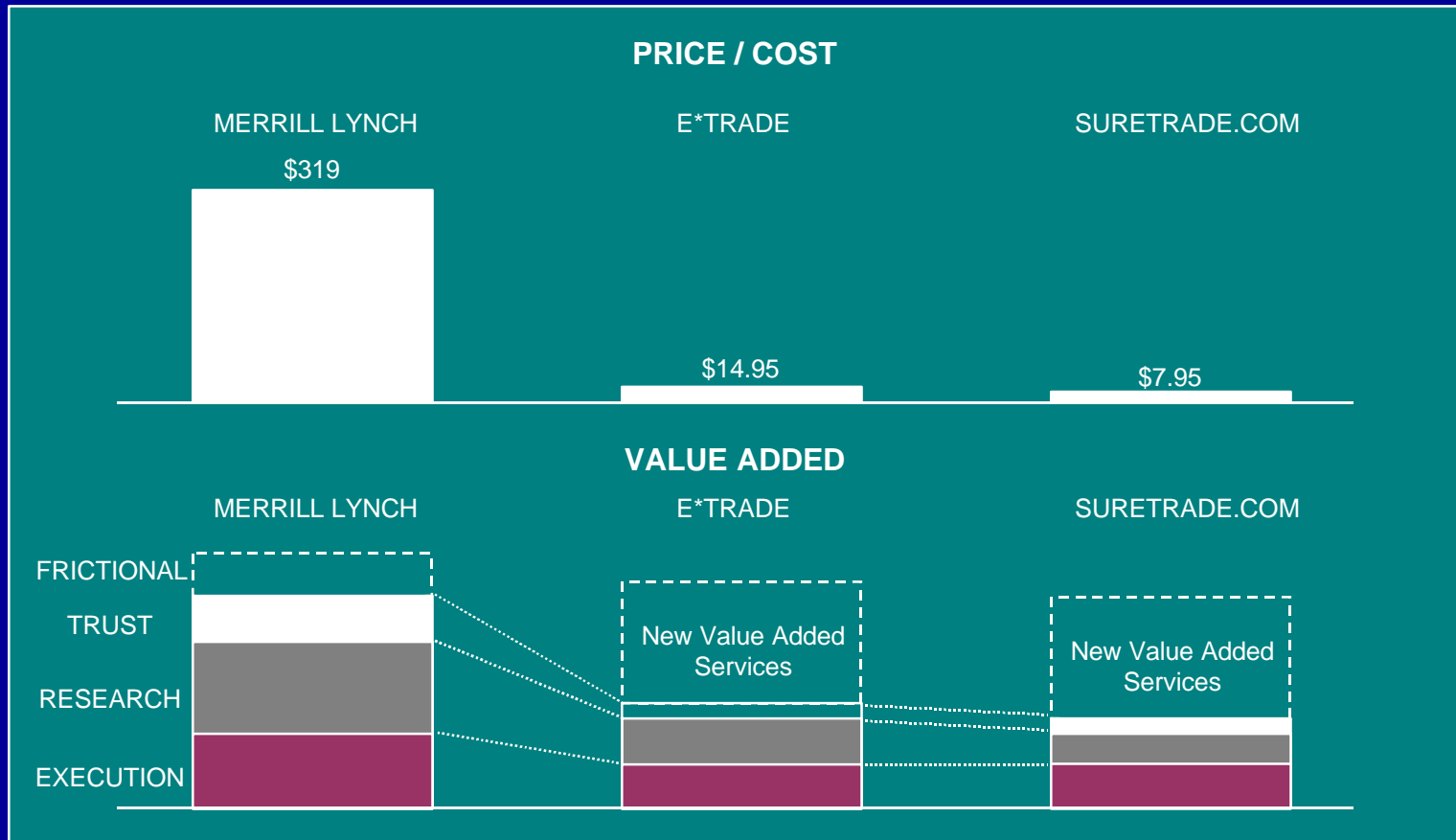
• Shifting sources of comparative advantage

Understanding the strategy implications requires an examination of the opportunities/threats of electronic commerce within a strategic review framework.

General observations...

- Substantial cost savings are likely.
- Potential value added increases are likely to be moderate.
- The “basis” of competition is likely to change or be altered... so you will need to change your strategy.

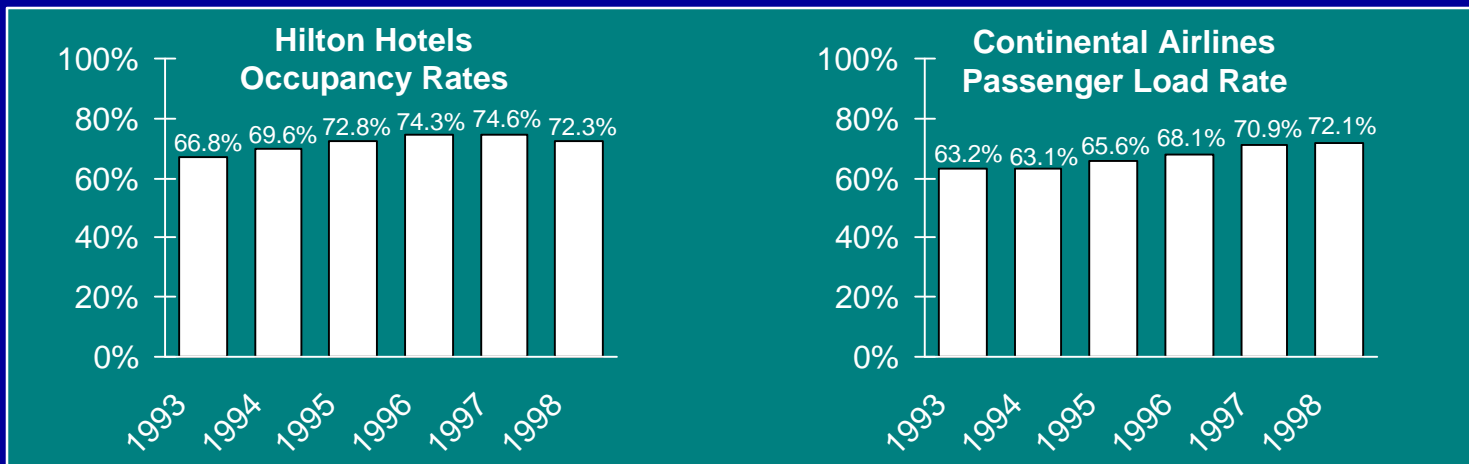
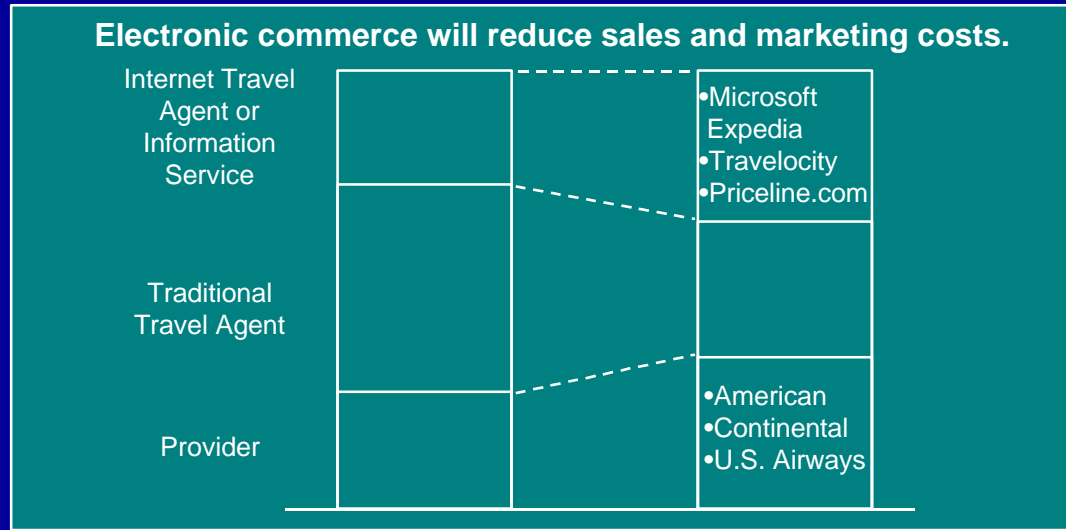
Electronic commerce has dramatically reduced the price structure of the retail stock brokerage industry while maintaining some of the key value added services.



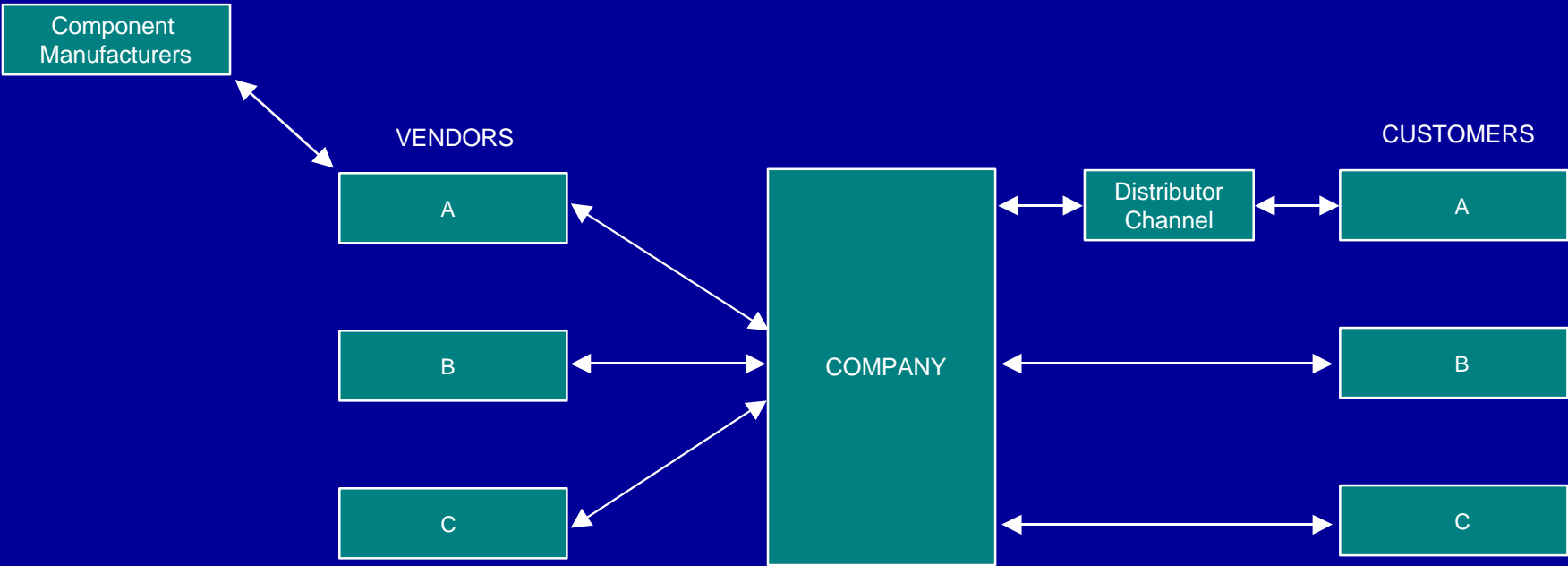
Note: Reflects 800 share trade of a \$20 listed stock.

Source: Merrill Lynch, E*Trade, Suretrade.com, Easton Consultants analysis

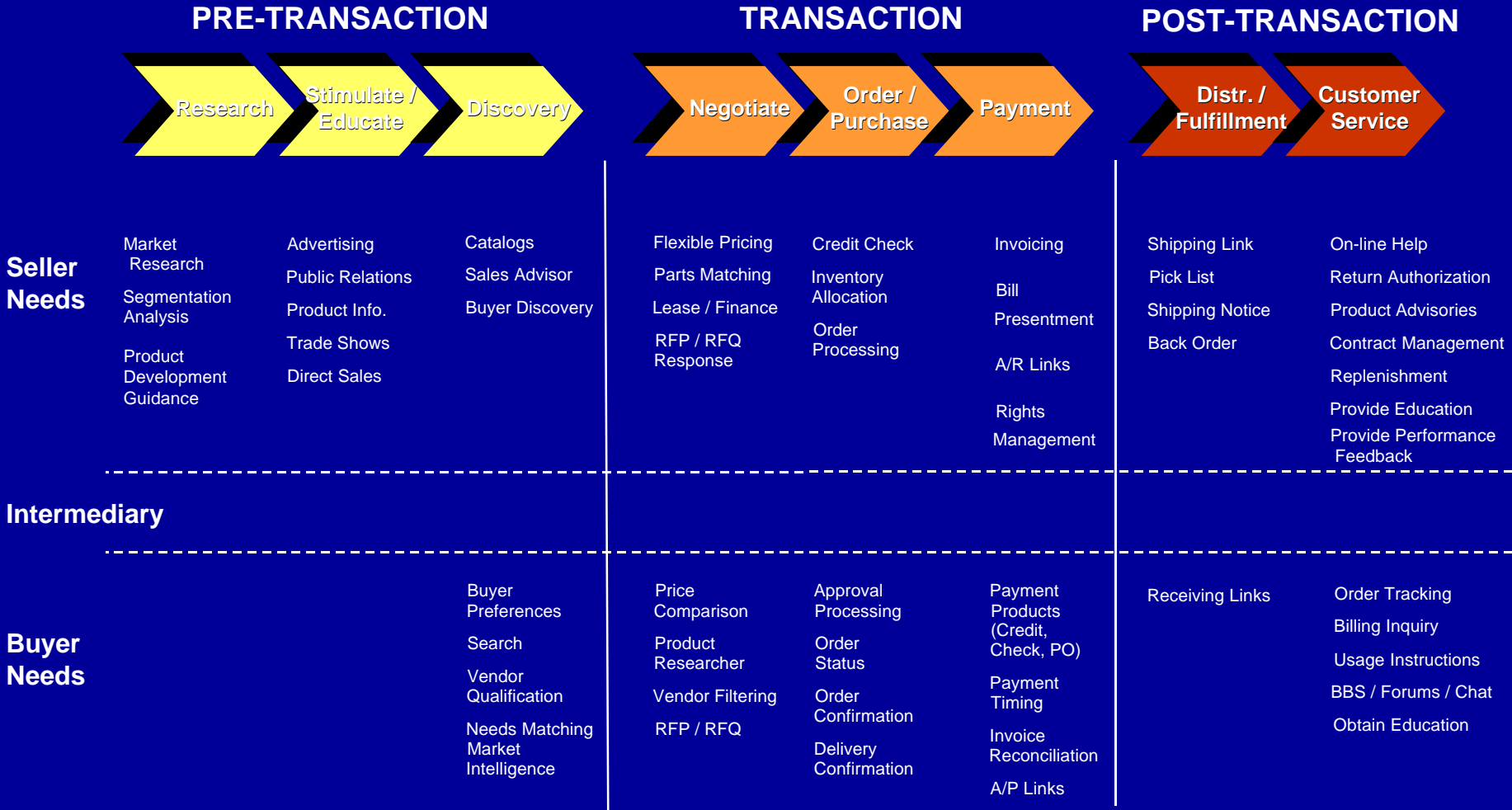
In the travel & entertainment industry, distribution channels will shift and capacity absorption rates should climb.



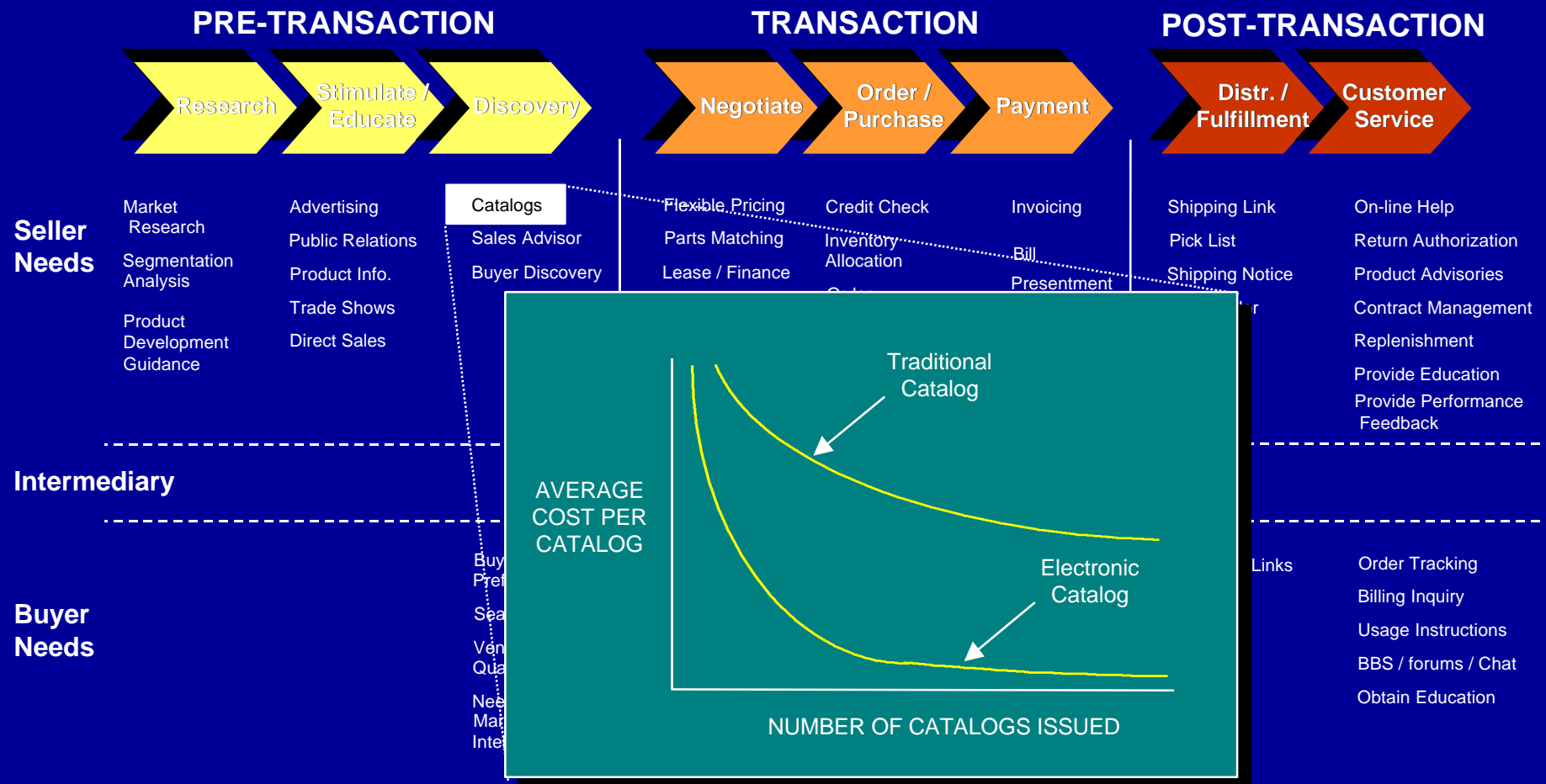
Savings and performance improvement can touch all participants in the industry network.



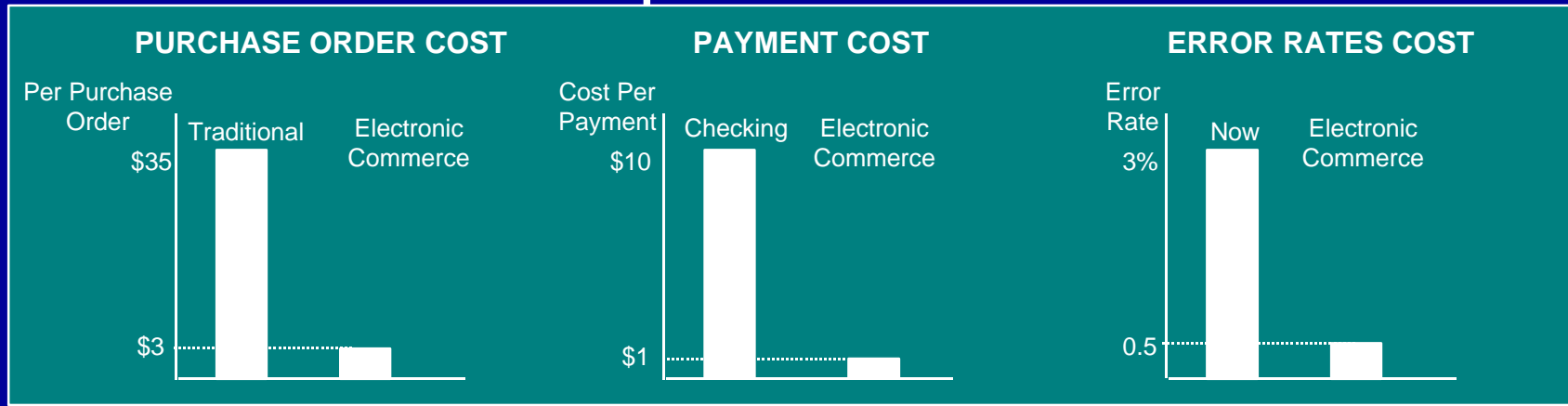
Each relationship can be characterized by a set of buyer needs and supplier needs.



The impact of electronic commerce is substantially driven by the leverage of improved information technology (faster, more detailed, more accurate) on buyer and seller needs and costs.



While the “saves” and implied value can be substantial...



...Electronic commerce is rarely a strategic solution.

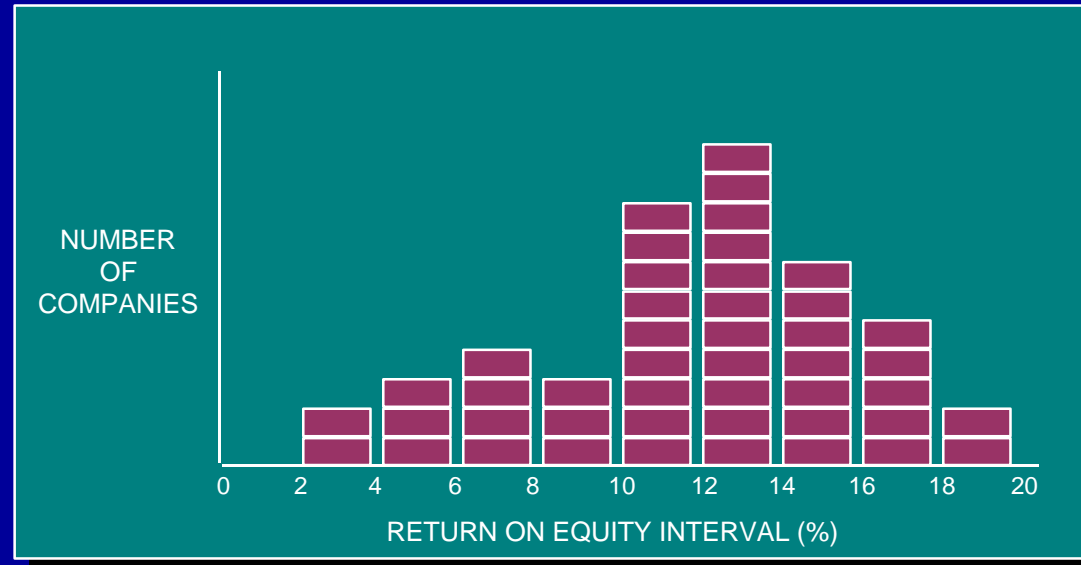
- Everybody has or will use “generic” approaches:
 - Electronic catalogs
 - Transaction engines
 - Specification sheet delivery
- The real question: How will electronic commerce initiatives **improve**, protect or destroy your comparative advantage?
 - Structurally?
 - Temporarily?
- Technology alone is available to all. The winners will find ways to use electronic commerce to create, protect, or extend their comparative advantage.

A framework for considering the impact of electronic commerce on strategy calibrates both value and competitive shelter.

- Characterize profitability -- (How might it change).
- Characterize variations in profitability among competitors... and what causes the variations.
- Consider and calibrate how electronic commerce elements might change them.
- Devise the electronic commerce support functions that strengthen your position.

A simple framework can be used to guide the process of evaluation.

Firms competing against each other in a business can be analyzed by their returns on equity and “stacked” in a distribution.

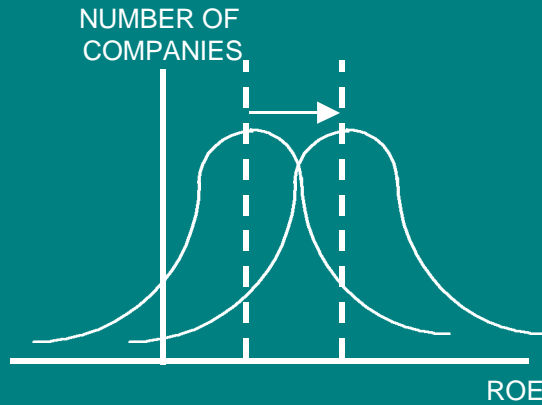


The overall profitability of the business can be characterized by the mean (or average) profitability of the business. We call the forces influencing the average “positional.” When these forces change, all boats rise or fall together.

The spread of profitability among competitors may be great or small, depending on the industry. We call the forces influencing the spread “performance.” Differences in performance are driven by how firms compare regarding core economic phenomena in that particular industry.

Firms can consider strategy improvements on two dimensions:

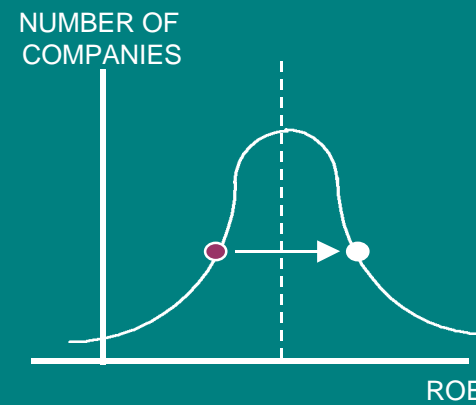
POSITIONAL STRATEGY: FIND A NEW MEAN



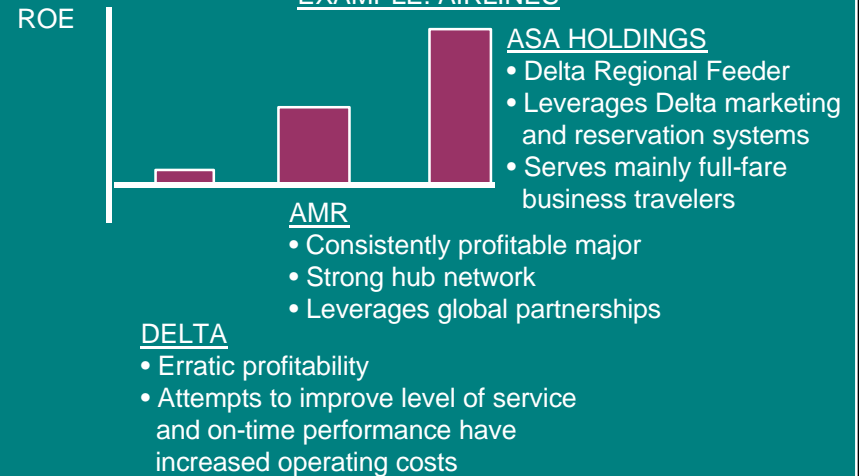
EXAMPLE: AIRLINES

- Economy growing - more bus. travelers
- E-ticket and Web site purchase take out SG&A cost
- Price of fuel
- E-saver weekend fares stimulate demand and improve capacity yield

PERFORMANCE STRATEGY: MOVE WITHIN THE SPREAD



EXAMPLE: AIRLINES



ASA HOLDINGS

- Delta Regional Feeder
- Leverages Delta marketing and reservation systems
- Serves mainly full-fare business travelers

AMR

- Consistently profitable major
- Strong hub network
- Leverages global partnerships

DELTA

- Erratic profitability
- Attempts to improve level of service and on-time performance have increased operating costs

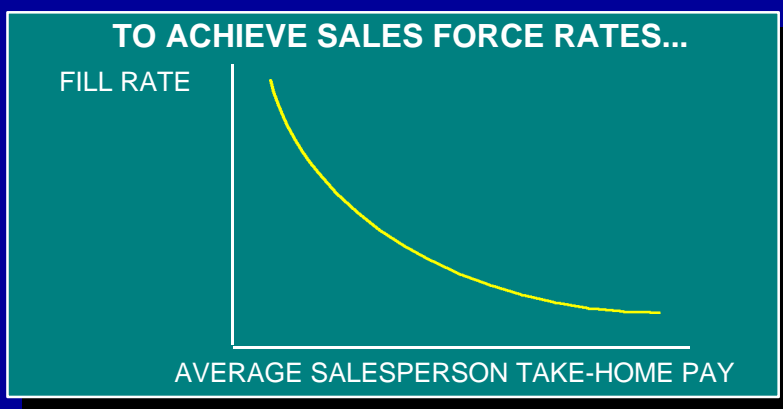
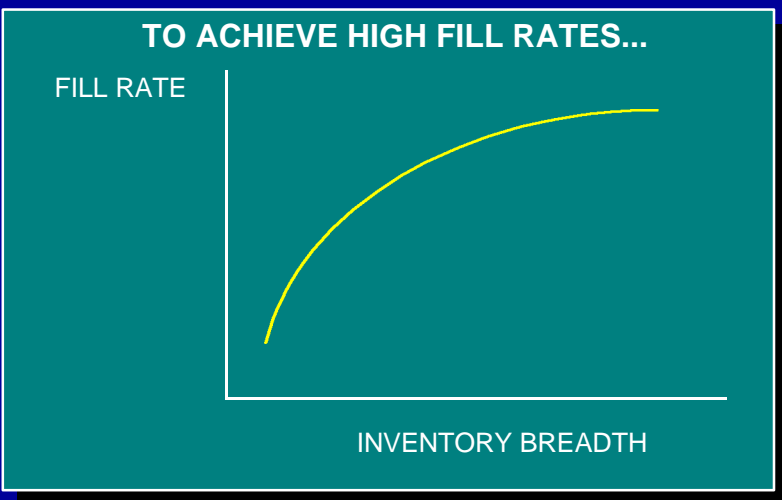
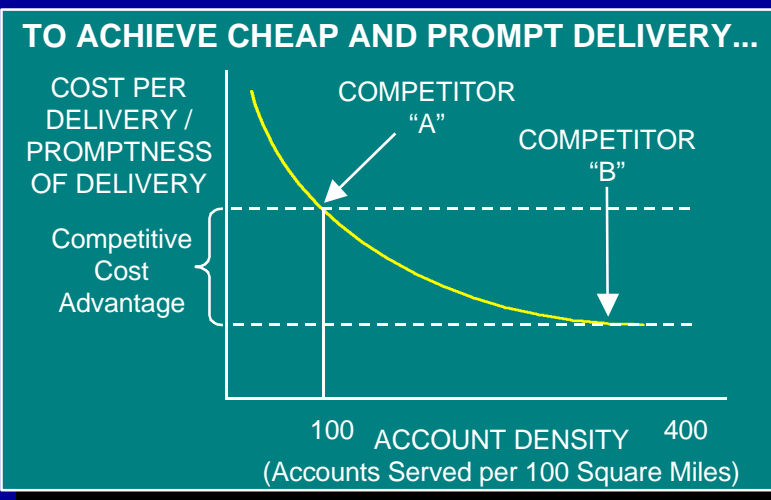
Spreads in businesses are created by key sources of comparative advantage. These economic phenomena have profound influence in characterizing difference in cost or value delivered by competitors.

Progressively *leverageable* cause and effect relationships.

- Exist in every business.
- Different in each business.

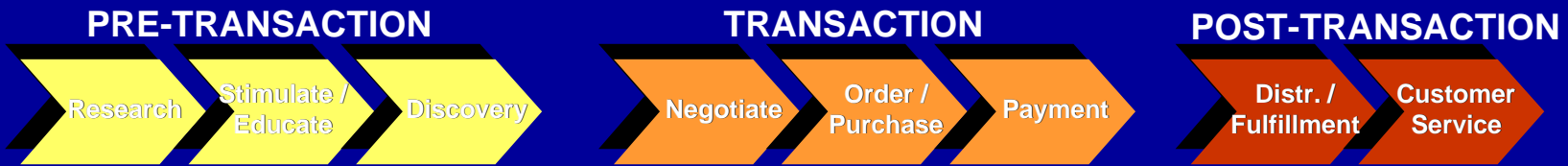
They are not the “critical success factors” in the business.

Let's review another example. In the office products distribution business, "critical success factors" might be: cheap and prompt delivery; high fill rates; and sales force recruiting. The key sources of comparative advantage are (arguably) as follows:



In the office products business, electronic commerce brings costs savings and superior performance in many functions. Analysis yields a few key points:

- Cost savings can be substantial: 7-10%.
- Buyers marginally interested in best price on an item-by-item basis.
- Problem avoidance is important.



	PRE-TRANSACTION	TRANSACTION	POST-TRANSACTION
Seller Needs	Market Research Segmentation Analysis Product Development Guidance	Advertising Public Relations Product Info. Trade Shows Direct Sales	Catalogs Sales Advisor Buyer Discovery
Intermediary		Flexible Pricing Parts Matching Lease / Finance RFP / RFQ Response	Credit Check Inventory Allocation Order Processing
Buyer Needs		Price Comparison Product Researcher Vendor Filtering RFP / RFQ	Invoicing Bill Presentment A/R Links Rights Management
		Approval Processing Order Status Order Confirmation Delivery Confirmation	Payment Products (Credit, Check, PO) Payment Timing Invoice Reconciliation A/P Links
		Buyer Preferences Search Vendor Qualification Needs Matching Market Intelligence	Receiving Links Order Tracking Billing Inquiry Usage Instructions BBS / forums / Chat Obtain Education
			Shipping Link Pick List Shipping Notice Back Order
			On-line Help Return Authorization Product Advisories Contract Management Replenishment Provide Education Provide Performance Feedback

Considering the strategy alternatives possible in the business, the information service alternative appears promising.

STRATEGIC ALTERNATIVES

		KEY FEATURE	CRITICAL BUSINESS SYSTEM ELEMENTS	"CONVENTIONAL WISDOM" PROSPECTS	
VENDOR DRIVEN	CATALOG	<ul style="list-style-type: none"> • Good price • Shipping cost • Cherry pick 	<ul style="list-style-type: none"> • Catalog development • Marketing 	<ul style="list-style-type: none"> • Catalog will be superseded 	
	LOCAL PRESENCE	<ul style="list-style-type: none"> • Service • High fill rate 	<ul style="list-style-type: none"> • Local inventory • Commission driven salespersons 	<ul style="list-style-type: none"> • Vulnerable to pure information services 	
BUYER DRIVEN	BUYER ADVOCATE	<ul style="list-style-type: none"> • Outsourcing the purchasing function 	<ul style="list-style-type: none"> • Purchasing contracts • Leveraging content 	<ul style="list-style-type: none"> • Outsourcing will reduce costs substantially, significantly beyond transaction cost saves 	
INTERMEDIARY DRIVEN	PURE INFORMATION SERVICE	<ul style="list-style-type: none"> • Connecting many buyers to many sellers 	<ul style="list-style-type: none"> • Sophisticated technology, from the GUI to transaction engines 	<ul style="list-style-type: none"> • Creation of connectivity will bring greater value to buyer and seller 	BEST STRATEGY

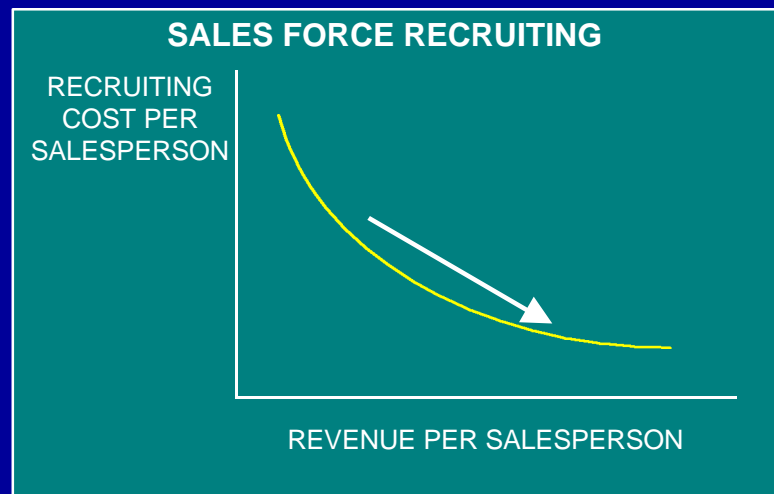
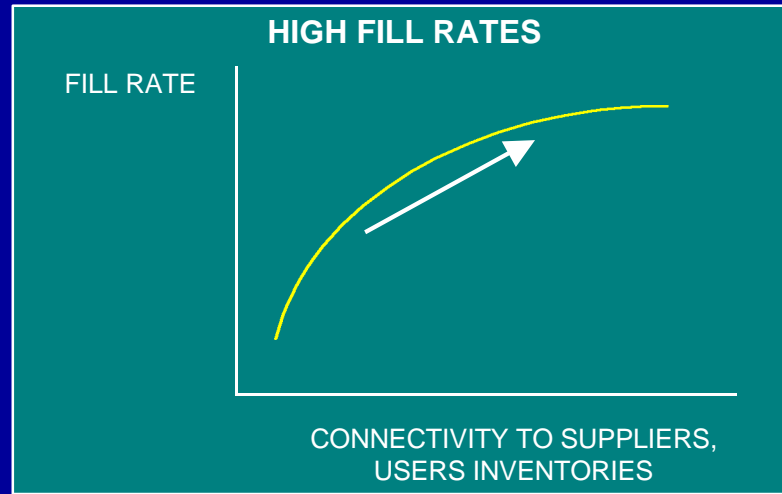
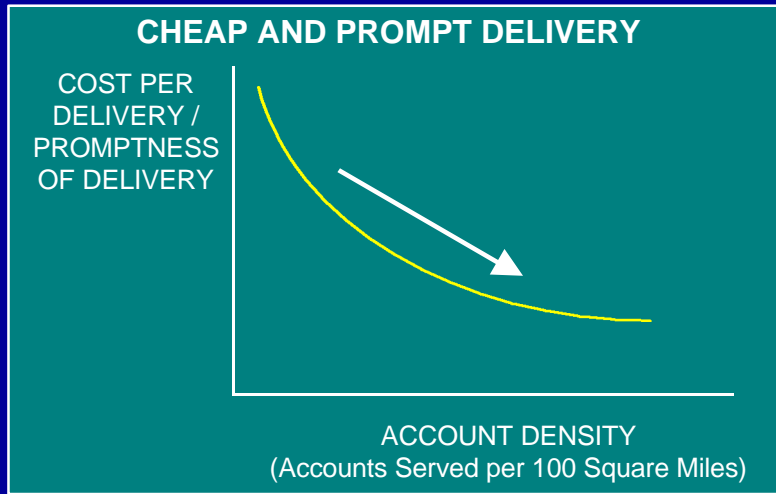
However, research indicates:

- Customers value local presence.
- Customers are not that focused on searching for the best price item by item.
- Customers frequently wish to talk to a “service person.”

And analysis of electronic commerce economics versus the traditional model suggests:

- Cost of account acquisition will fall.
- Cost of a tele-sales “visit” will fall.
- Transaction costs will fall.

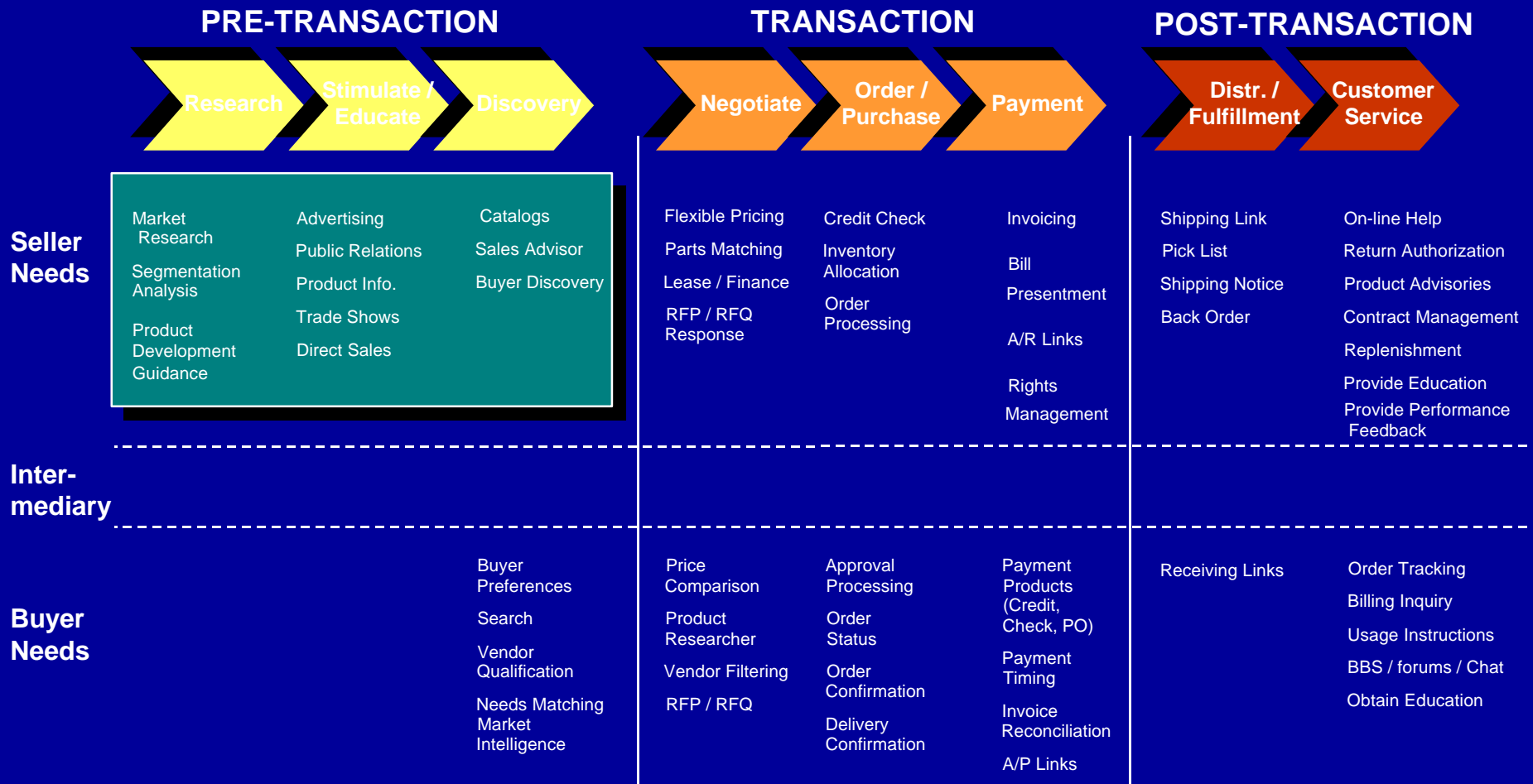
Rather than destroying the existing business model, it is likely that electronic commerce will leverage it.



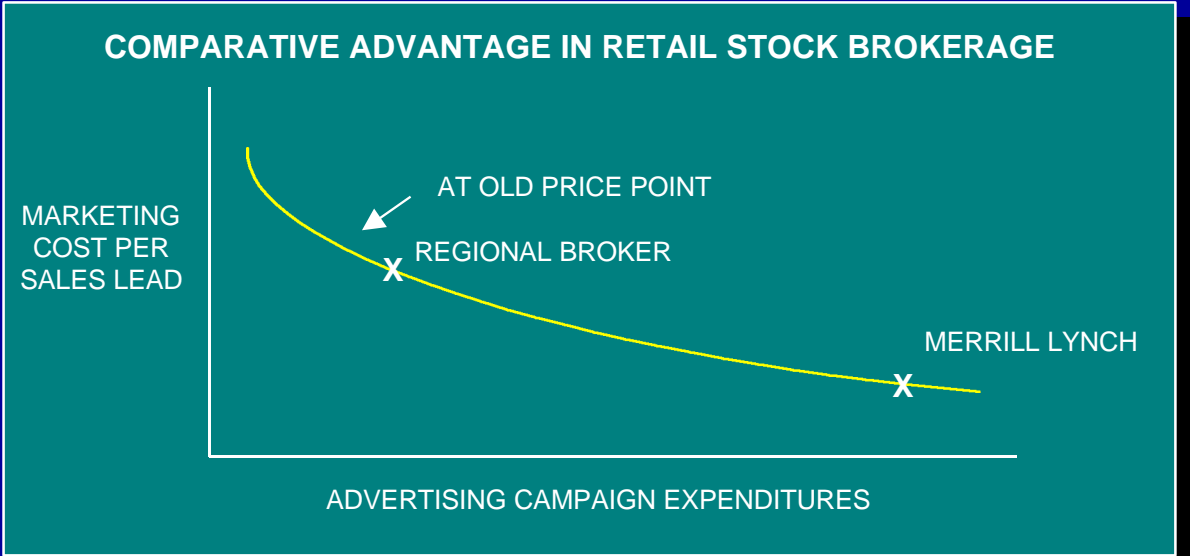
... indicating a different answer to the “best strategy” question.

		PROBABLE OUTCOME	
VENDOR DRIVEN	CATALOG	<ul style="list-style-type: none"> Catalogs will likely be subsumed by large office companies. Catalogs are truly “another channel”. 	BEST STRATEGY
	LOCAL PRESENCE	<ul style="list-style-type: none"> National chains will adapt their business model to electronic commerce, increase salesperson productivity and increase warehouse picking utilization. Margins will shrink as business model speed increases. National chains will “give away” electronic commerce benefits to extend market reach. 	
BUYER DRIVEN	BUYER ADVOCATE	<ul style="list-style-type: none"> Electronic efficiency will bring benefits, but nowhere near claims. Fewer and fewer vendors will use “direct cost” model to price large accounts. 	
INTERMEDIARY DRIVEN	PURE INFORMATION SERVICE	<ul style="list-style-type: none"> Vendor systems will match information service offerings with probable exception... <u>comparisons</u>. Our research suggests this will be a minor advantage, compared to traditional sources of comparative advantage. 	

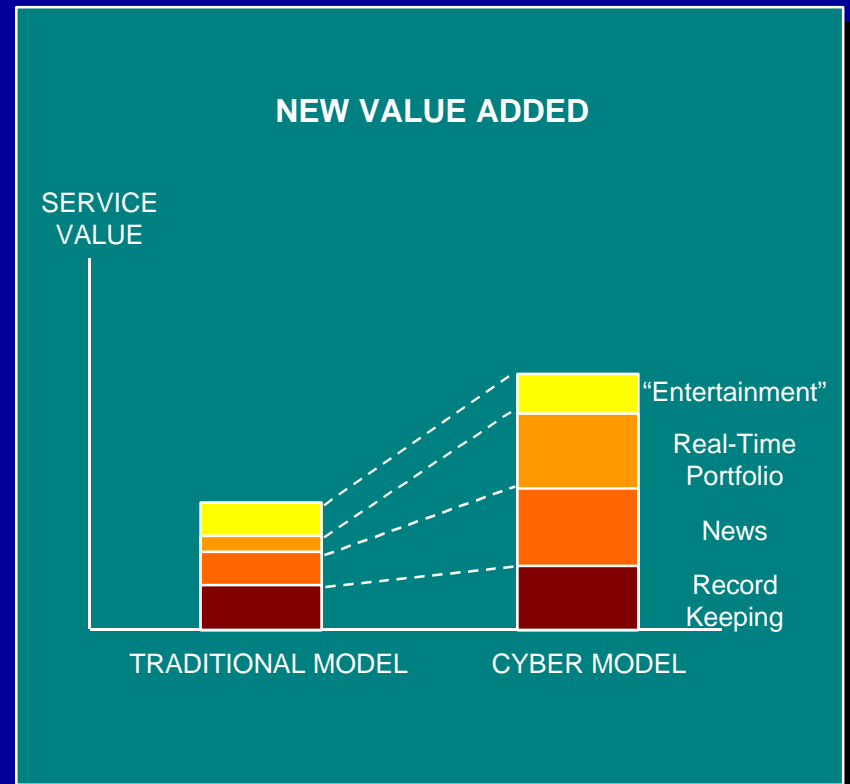
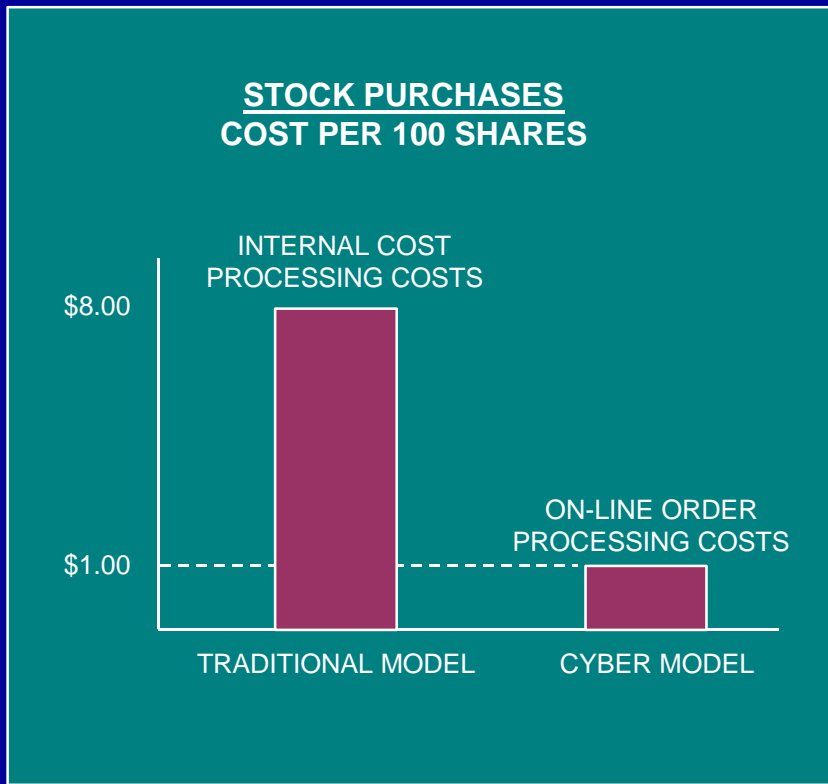
In the retail brokerage business, the pre-transaction seller needs are a critical element of the business system.



In the traditional model, one of the most important sources of comparative advantage is the relationship between advertising and sales lead generation.

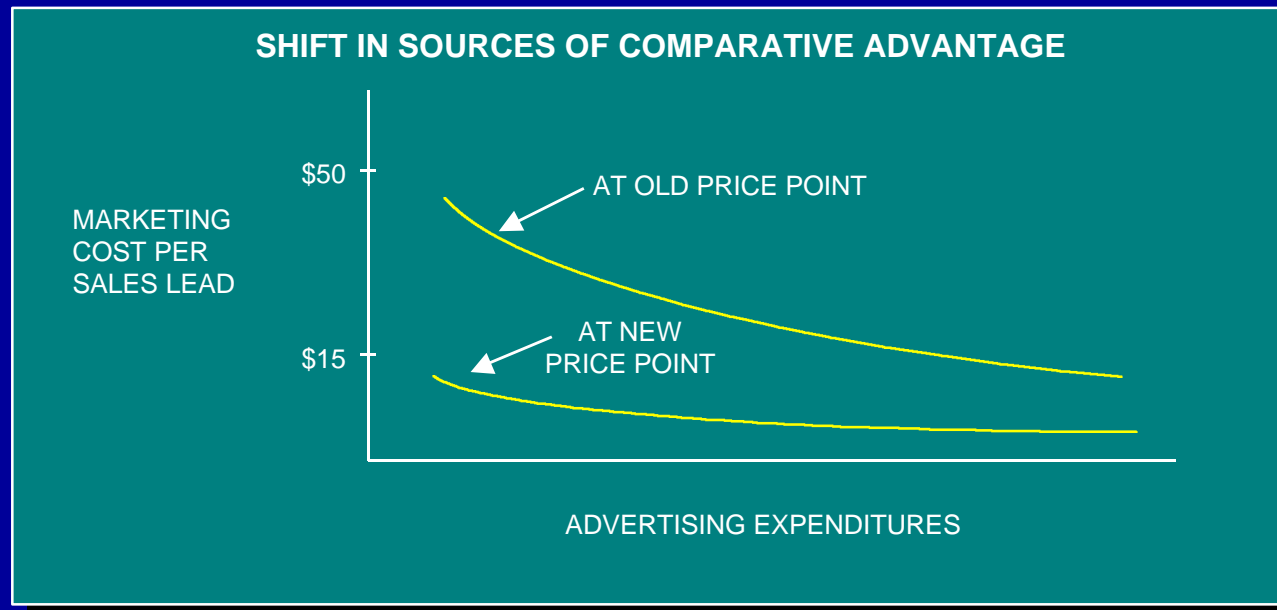


But this economic relationship has been challenged by the very significant efficiencies in transactions and improved service value offered by the cyber model...



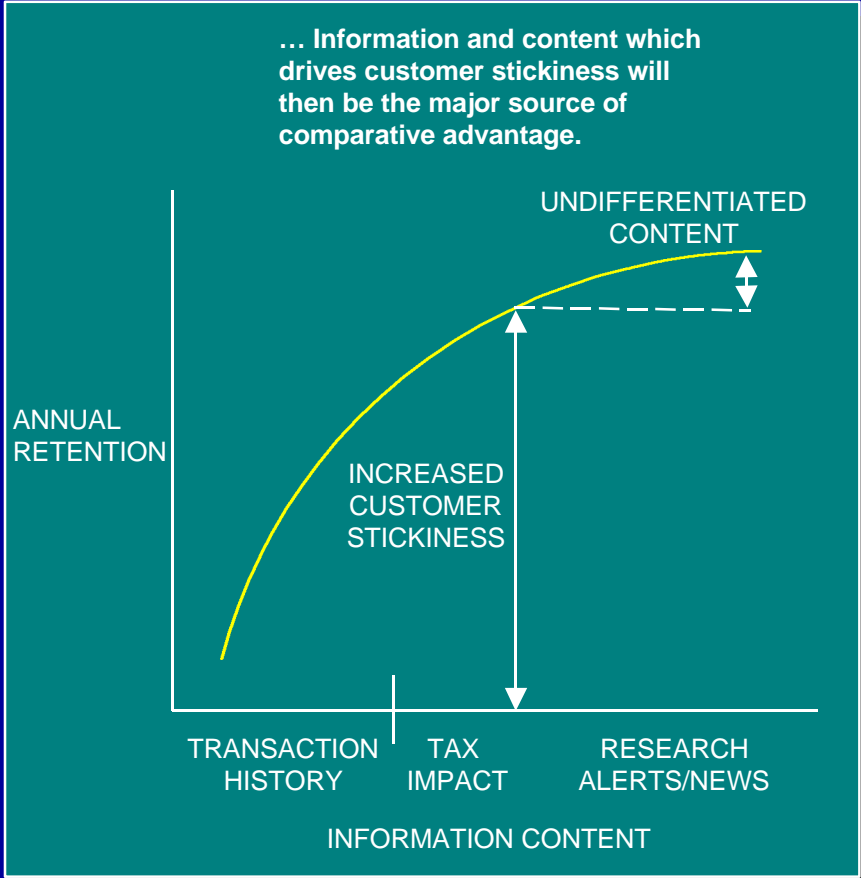
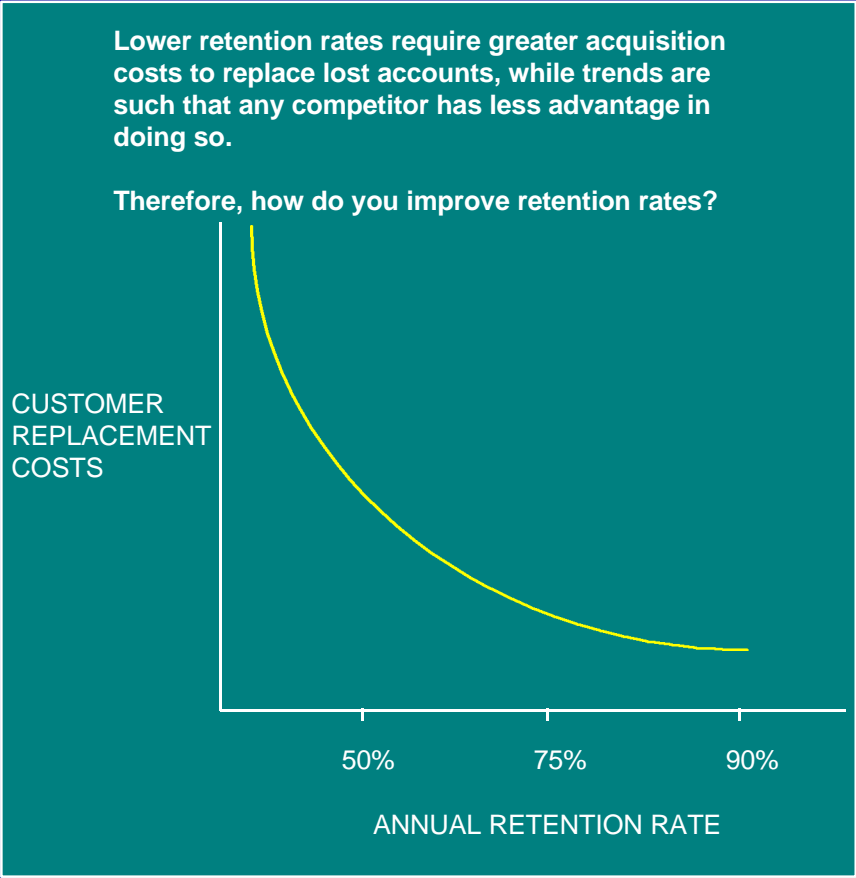
The new cost and value structure causes advertising “yields” to rise, significantly lowering advertising costs per customer acquisition.

The curve resulting from the new price point is lower and flatter, weakening this source of comparative advantage.

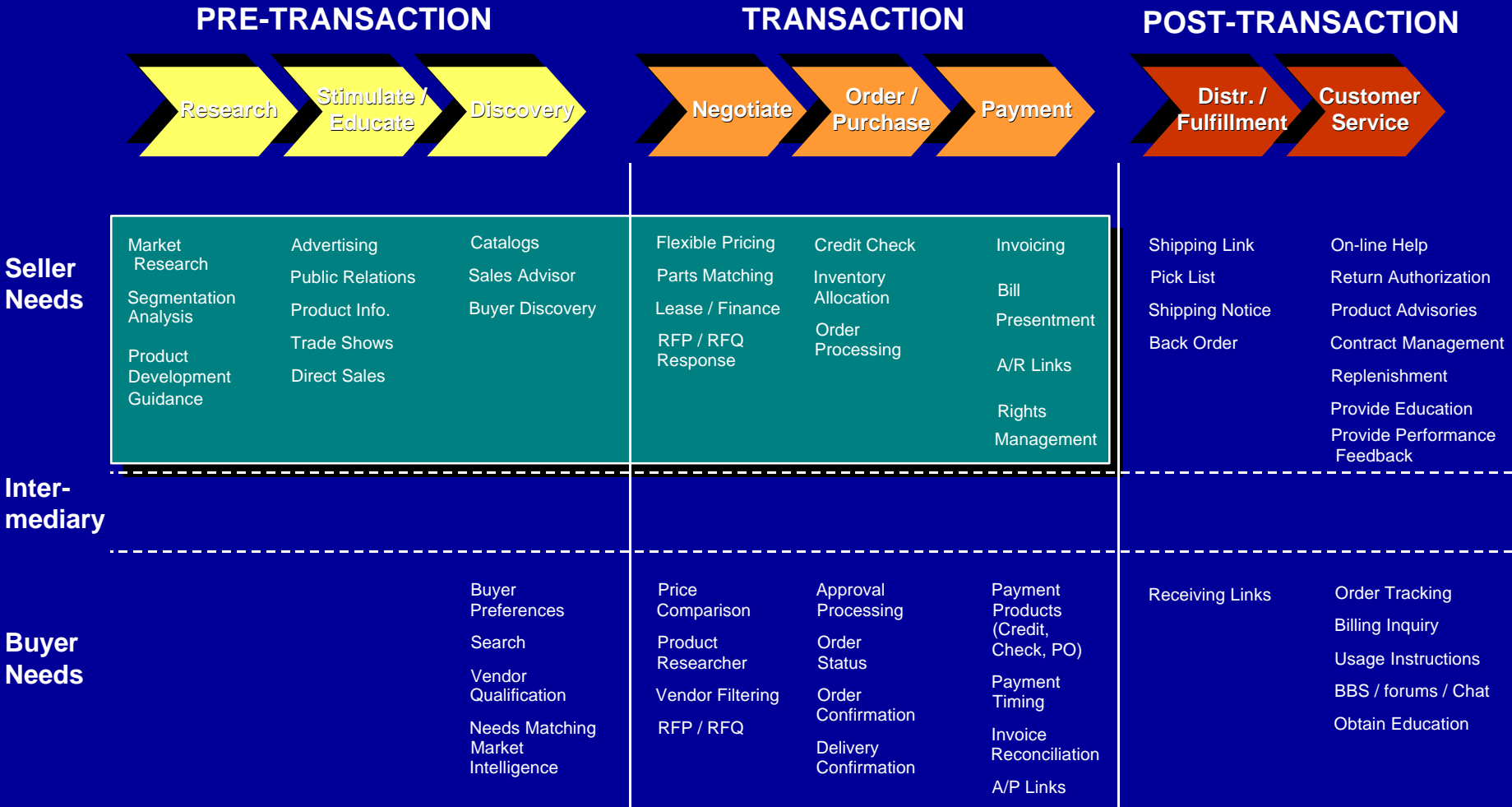


If account acquisition related to advertising revenue has been a key source of comparative advantage in the past, what might it or they be in the future? We can propose a candidate.

Account retention -- related to the "robustness" of customer information integration and service extensions.



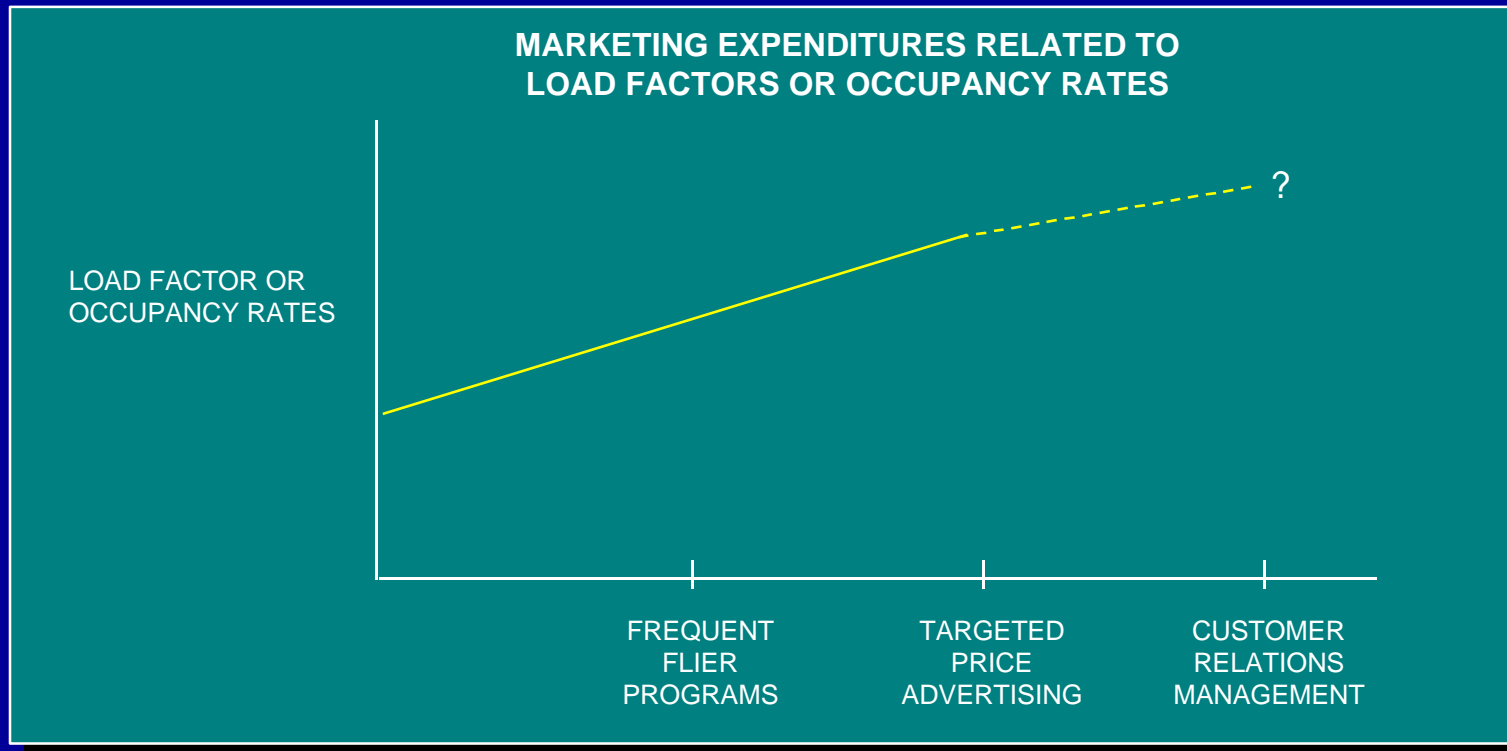
In the T&E businesses, electronic commerce will have greatest impact in the pre-transaction and transaction phase.



“Traditional” sources of comparative advantage have been weak.

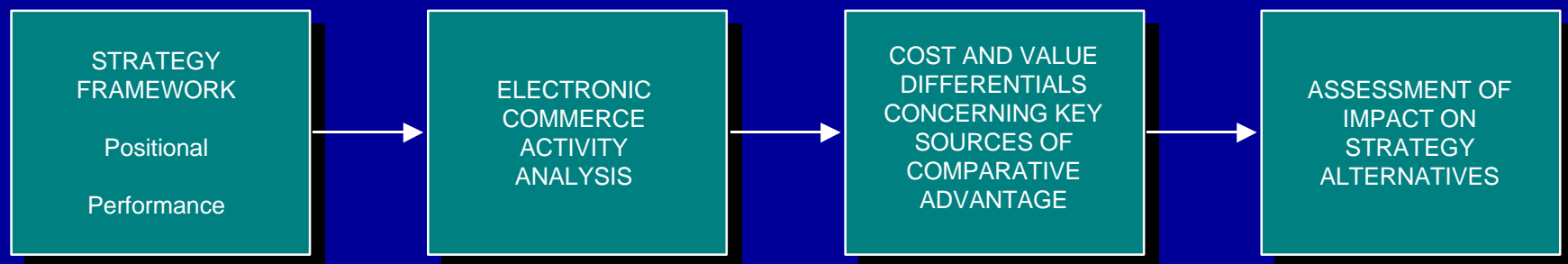
- Marketing expenditures related to occupancy rates or load factors.

Electronic commerce will take cost out of the business model, but it could conceivably strengthen the sources of comparative advantage. Load factors could be improved through better customer knowledge and on-line price management.



Each business is unique and the opportunity and/or threat of electronic commerce will be different. The challenge for firms is to establish a way of considering electronic commerce that leads to well-grounded and well-supported conclusions. They can be developed with:

- A strategic framework.
- Actual market information regarding customer wants and needs.
- Analysis of how activities and information flows will be changed by electronic commerce.



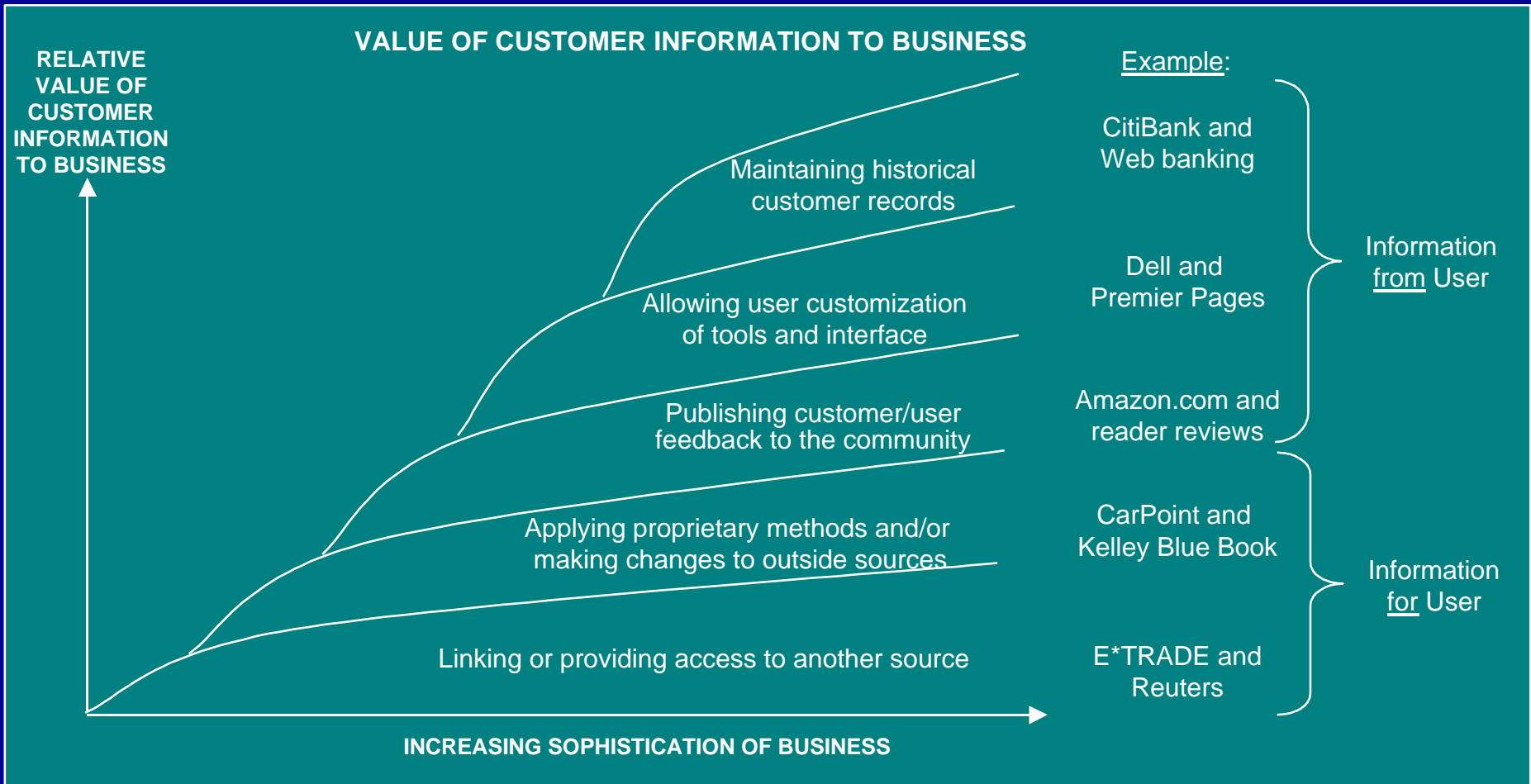
The key challenge is not to discover the alternative that eliminates the most cost. It is to find the best way of maintaining and improving your competitive prospects...

- Providing access to new revenue streams.
- Strengthening competitive shelter.

...by leveraging electronic commerce phenomena.

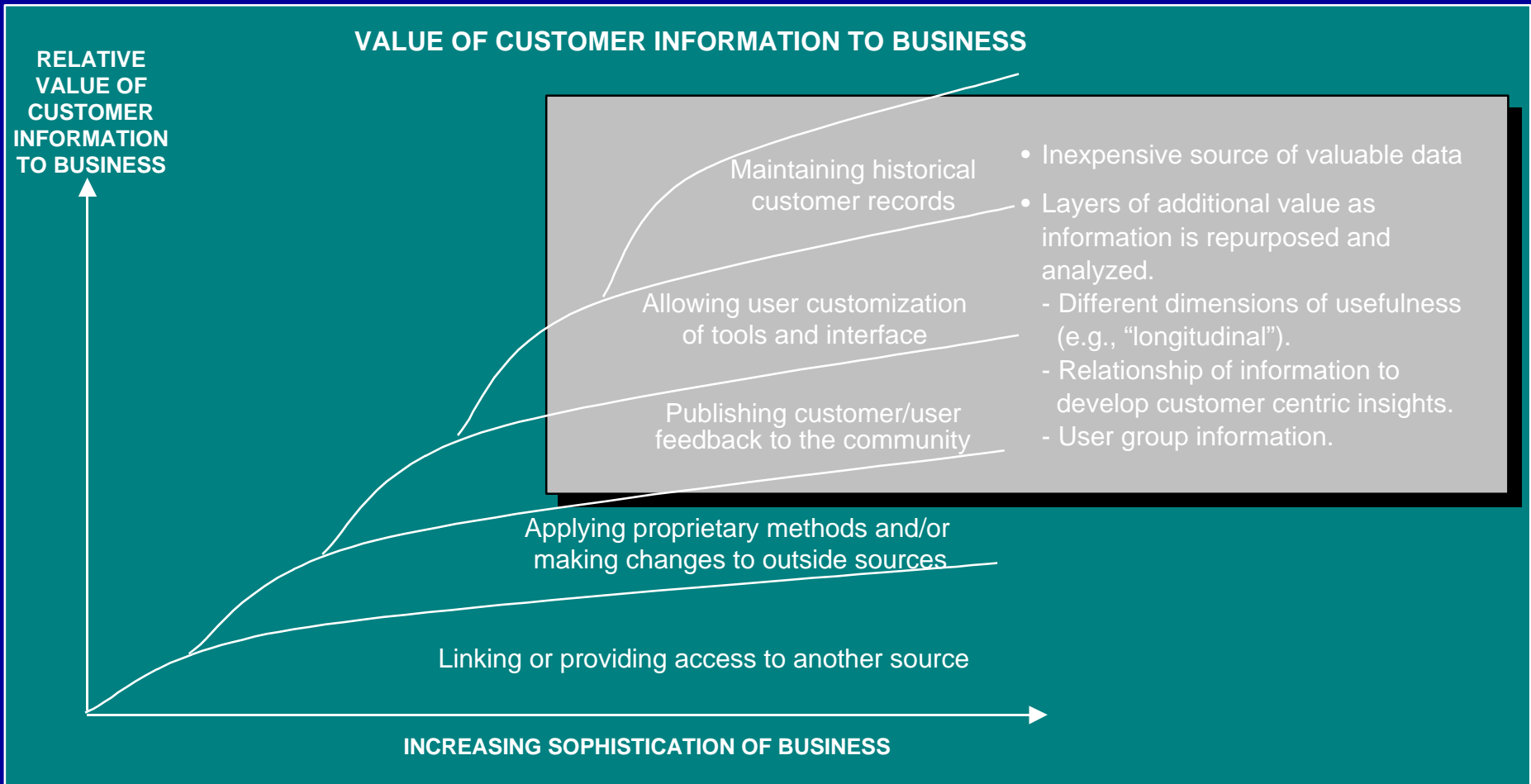
What are the potential information differentiators in the new business models?

- Lesson #1: Search for unique and leverageable content additions.



What are the electronic commerce phenomena in the new business models?

- Lesson #2: Customer information is the **key** differentiator.



What are the potential information differentiators in the new business models?

- Lesson #3: Build (not swell) your business model.

Expanding Strategically

- Broadening or deepening your business model if new information access gives you special advantage.

Strengthening Competitive Position

- Investigating how electronic commerce can help your distributors win more business and take costs out of their business model.
- Shortening the product life cycle based on customer feedback loops.

Uncovering Value in Existing Business Elements

- Searching for alliances with under-utilized information sources and brands.

Be alert to common pitfalls.

- Reducing the development of electronic commerce to a technical project.
- Building electronic commerce platforms based on “logical” value perceptions.
- Holding to the “last in, best dressed” philosophy.
- Relying on reverse engineering.

Comments and questions can be directed to:

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