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Try Before You Buy

*The Ups and Downs
of B2B Exchanges*



*Illustration by
Gyula Géfin Grafix*

E-markets have had their ups and downs. It's been interesting to watch the pendulum swing, from an uncritical acceptance of excessive hype to an equally uncritical rejection of the very idea itself. But through it all, exchanges have weathered the challenges and disillusionment, and are still very much with us. What are the secrets of success - and the lessons to be taken from the failures?

By Andrew Brooks

At its most basic level, the function of a B2B exchange is to act as a simple 'transaction hub' where buyers and suppliers can meet to do business. It was the lure of such a model that led many early entrants to adopt the famously unsuccessful "build it and they will come" attitude as the B2B exchange model began to take off at the end of the 1990s.

As it turned out, this approach drastically underestimated the complexity of doing serious business online, and also ignored the rising expectations of buyers and suppliers. Mere months after business and industry analysts were predicting an exponential boom in the growth of B2B exchanges and the volumes of transactions that would be conducted through them, many had closed or were in financial difficulty, had changed their business strategy, or had merged with or been acquired by competitors. And just as quickly, the tide of opinion seemed to turn against the B2B exchange, dismissing it as a technological quick fix with little or no enduring business value.

End of story? Not exactly. According to William Woods, author of *B2B Exchanges 2.0: Not all e-markets are "dot-bombs"* in an e-mail interview with *Purchasingb2b*, there were a number of reasons for the initial reverses:

The major reasons for the disappointment caused by B2B exchanges so far are:

- the failure of many B2B exchange business models due to an inability to build sufficient liquidity;
- the failure to build-out many exchanges beyond a simple Internet e-catalogue, and thereby capitalize on "early mover" advantage;
- the belief that the B2B revolution could occur overnight without regard for the time required to achieve integration of disparate IT systems;
- a miscalculation of the relative importance of "neutrality" versus market domination; and
- that we all underestimated the time it would take to change people's behavior to take advantage of the new technology.

"There's no question the whole exchange/dot-com model was over-hyped - and wound up underperforming," says Jim Neikirk, president and CEO of Pantellos, an electronic utility trading exchange and one of the more successful examples, with 20 of North America's largest utilities on-board. "Exchanges today are a lot different from what was envisioned earlier on, but the overall vision has not changed."

The Vision Thing

However a lot depends on what that initial vision was. Many B2B exchanges, whether established by consortia of buyers or suppliers or by 'neutral' third parties, never looked past the initial establishment of a simple transaction hub, and were thus unprepared to evolve when users had leveraged the first quick-hit savings from basic exchange tools like reverse auctions, and began to look for more sophisticated supply chain offerings.

Pantellos itself is an example of how more forward thinking has paid off in the long run. The exchange has recently released positive cash flow and EBITDA figures, and is now known as one of the most successful exchanges around. For Neikirk one big reason for that bottom-line health is that Pantellos was never created to a "pure" exchange model, but with the intention of adding more supply chain services for buyers and suppliers as the demand arose.

"We created Pantellos as a services company with the distinct purpose of saving money and lowering costs for buyers and suppliers," Neikirk says. "Besides being a platform for transacting business, we want to provide a balance of supply chain services as well as those 'traditional' marketplace services."

Building the Footprint

That approach strikes a responsive chord in Brad Tobin, chief procurement officer and vice-president, supply chain with FirstEnergy, a major northeastern U.S. electrical utility.

"Pantellos has admirable flexibility," Tobin says. "They develop new offerings and bring them to the users, who can then try them out. If it's good, they use it; if not, they just drop it. Some products and services have worked, some haven't."

Recently, Tobin says, Pantellos has been working on developing new e-invoicing and e-settlement services – a key function that seems to be in demand across the full spectrum of B2B e-commerce these days, and one that FirstEnergy is eagerly anticipating. By way of a less successful example – or at least one that FirstEnergy decided it would give a miss – Tobin recalls a project collaboration tool that FirstEnergy tried out.

"We have people here called architect engineers, and they could use this tool to design a product via the Internet and turn it into a reverse auction event [to procure the required parts and materials]. We tried it for about a year but eventually abandoned it. It wasn't quite there in terms of what we were looking for."

Evolve or Else

For Kerry Lamson, vice-president and general manager, global membership for CommerceNet – which recently merged with the Open Network for Commerce Exchange (ONCE) – e-marketplaces today have sorted themselves into three basic models. Many have become specialists in performing the integration and technology work that companies need to have done in order to participate in an exchange (especially as exchanges have evolved beyond transaction hubs and started to offer more sophisticated e-commerce services and capabilities).

The second model is the industry-focused marketplace, which is now seeing significant uptake. One challenge for some of the more established examples is getting smaller buyers and suppliers, who tend to be less technologically capable, up and running.

"The Fortune 1000 companies are still around 60 to 70 per cent of our membership," says Lamson. "We're continually working at getting companies connected, in particular the smaller businesses."

Because smaller buyers and suppliers tend to be IT beginners, the work of getting them on-board tends to be on simpler pieces, like electronic catalogues, one aspect of e-business that is definitely labour-intensive. Lamson says that ONCE has announced a new "correct-on-capture" e-catalogue solution, and expects it to launch early next year.

"Thirty-five per cent of the cost of an e-catalogue implementation," he says, "is gathering information, and the rest is in going through it all to get it correct and according to agreed-on specifications." There will be a

small fee, Lamson says, to accommodate the continual maintenance, updating and additions that any e-catalogue requires, but it will be kept affordable for small businesses.

The third model is the kind of exchange that is only now starting to emerge: Lamson thinks of it as a business syndication model or "business process network," where users streamline and automate complex business processes such as invoicing and settlement. As we've seen, forward-thinking B2B exchange users like FirstEnergy are very keen to get to this more sophisticated level of e-procurement, and are even looking farther ahead.

"The next big thing will be engineered materials – anything requiring some degree of engineering," says Tobin. "Then some of the things we will get to will be reverse engineering, SKU reduction, and further down the road we'll be able to get two or more companies together to 'whitesheet' components and engineered materials."

Tobin's confidence is a clue to the success of B2B exchanges: it's a question of evolution.

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Building True Value

Why E-markets Are Still a Killer App

By William A. Woods

Despite the common perception in the media that B2B exchanges have failed, e-business is inexorably penetrating deeper and deeper into business organizations, moving beyond customer-facing websites, and generating more far-reaching projects in back-office areas like logistics and supply chain management. In fact, companies are now focused on integrating the Internet into everything they do in order to survive.

Successful B2B exchanges are helping to provide the platforms for this new level of on-line collaboration across the supply chain and for improving trading efficiency. They are being used in four ways:

- As public, on-line marketplaces through which users secure improvements in the efficiency of the trading process, get greater price visibility, are able to set prices, and to find new suppliers;
- As an important way to improve operational efficiency, supply chain management and product design through the development of private networks and collaborative communities;
- As communication hubs through which suppliers, customers and logistics providers are able to interconnect their internal systems to realize productivity improvements and to access web-based services;
- As the platform for straight through processing of the "back-end" processes so as to improve logistics and fulfillment, enable product tracking, and secure efficient clearing and settlement and payment processing.

Global Reach

The cost of accessing the Internet is falling daily and the cost of sending information by e-mail or over the Web is a fraction of standard telephone, fax and mail costs. This means that sellers

can reach out to buyers all over the world and buyers can access sellers from all over the world. B2B exchanges create a community of those buyers and sellers in a structured and organized fashion. The low cost of getting connected, irrespective of geographical distance, enables fragmented buyers and sellers to find each other through a B2B exchange without incurring real-world search and travel expenses or high commissions for using intermediaries.

Enabling E-procurement

A key goal of any procurement operation is to find the best deal, the right products, sufficient product availability, and acceptable prices. B2B exchanges have enabled companies to automate the procurement of

goods and services from multiple suppliers. E-procurement allows a company to monitor its purchases more easily, and therefore reduce the amount of redundant or repetitive purchases. On-line procurement increases price transparency and facilitates new supplier discovery. Finally, e-procurement enables a company to take advantage of dynamic pricing, in the form of on-line catalogues, automated RFPs, or buyer-driven or seller-driven on-line auctions.

Collaborative Communities

It is in the area of supply chain management where B2B exchanges are now delivering most value. B2B exchanges are increasingly as focused on developing their supply chain management functionality as on building their central, public e-marketplaces. Both public and private B2B exchanges have the capability to tie together the manufacturer with its suppliers (Tier 1) and its suppliers' suppliers (Tiers 2 and 3). This can lead to a collaborative process that generates greater efficien-



cies in the design of products and significant reductions in the time and cost of manufacturing.

The exchange therefore becomes a collaborative trading community. In this way, the benefits of the B2B exchange extend well beyond the function of bringing buyers and sellers together and result in major process improvements as well.

Some suppliers have been reluctant to work with B2B exchanges, because they think that reverse auctions only benefit the buy side. By enabling deep collaboration, supply-chain management functionality provides great benefits to suppliers, which can help counter-balance the negative effects that suppliers perceive from reverse auctions run through a B2B exchange.

Some of these types of applications are now called collaborative planning, forecasting and replenishment (CPFR). In order to be effective, CPFR and other e-business enabled supply-chain applications must support:

- sourcing – to help locate suppliers, evaluate their offerings and make comparisons;
- contract-management capabilities – to facilitate contract negotiation, maintain contract terms and pricing details, and ensure that the proper contractual terms are applied to each order;
- competitive bidding – to facilitate the generation of requests for quotes that include detailed line-item criteria, to share the RFQ with the suppliers and to manage the bidding process;
- collaboration with suppliers – to enable the manufacturer to share information about the state of the company to improve forecasting and demand planning and to promote efficiency by co-ordinating business processes; and
- collaboration from suppliers – to enable suppliers to respond to detailed RFQ specifications or to requirements received through integration with the manufacturer's ERP system.

More Efficient Distribution Channels - B2O

Once a manufacturer goes on-line it can reach out and touch the end consumers of its products, without the need for retail distribution channels. Those channels were developed to enable the manufacturer to achieve the maximum distribution of its products in a pre-Internet environment. They also helped the manufacturer to manage inventory levels of completed products and to store that inventory, in return for a percentage of the sale price. Now a manufacturer can get orders from consumers directly over the Internet and then move to a "build-to-order" (B2O)

program – just as Dell Computers has for PCs. A B2O business model can dramatically reduce manufacturing time, inventory levels, and distribution costs.

In addition, a B2O business model reduces the amount of inventory that sits unsold in the sales channels. This means that the benefits of new designs, reduced costs, and improved technology can be passed on to the end customers at a much faster rate.

Catalysts for Web Services

Web services are the latest tool for integration of software between businesses "across the firewall." Web services build upon an existing set of communications protocols that have been spectacularly successful – the Internet – and attempt to use it for true program-to-program integration. Web services comprise:

- providers, who publish the availability of their services;
- brokers, who register and categorize the services of the service providers; and
- users, who use brokers to find a provider's service.

B2B exchanges are communication hubs, through which suppliers, customers and trading partners can connect their systems – and are therefore acting as catalysts for the development of business web services. Rather than each company creating multiple "one-to-one" electronic links with every party it wishes to do e-business with, a company can link up once to a B2B exchange and create a more efficient "one-to-many" connection.

Market Domination

B2B exchanges create an electronic, "virtual" marketplace that I call a market "space." Increasing returns will lead to a concentration of buyers and sellers in one B2B exchange market space for each product. One B2B exchange may operate several market spaces, but only one market space is likely to dominate for each product.

Eventually, all companies operating in a particular market space will have to join the B2B exchange that dominates in that space. The process of joining and connecting to that B2B exchange will continue to be one of the main drivers behind the use of the Internet and the adoption of XML by companies. **b2b**

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